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In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 9921

ISI CORPORATION, R. L. McKEE, E. R. FOLEY, and ELWOOD MURPHEY,

Petitioners,

vs.

ALMA M. MYERS and MYRTLE G. CROMWELL, as Executrices of the Will and Estate of Ethel I. Bumbaugh, STEVEN G. OPTON, LAWRENCE and ELISABETH NORMAN, SECURITY PACIFIC NATIONAL BANK, W. H. DRAPER, JR. and W. W. WEETH.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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ISI Corporation,[1] R. L. McKee, E. R. Foley and Elwood Murphy pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit en-

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Emphasis in quotations has been supplied unless otherwise stated.

"App. ....." refers to the Appendix to this Petition; "R. ....." refers to the first three volumes of the transcript of record in the Court below; "Tr." refers to the reporter's transcript of proceedings in the District Court.

1. ISI's name at the time the action was commenced was "Insurance Securities Incorporated", and it was so sued. Its name has been changed since then, first to "Insurance & Securities Incorporated" (R. 487) and later to "ISI Corporation".

tered August 28, 1970 in three consolidated appeals, Nos. 23,489, 24,548 and 23,582, in a case entitled *Lawrence and Elizabeth Norman v. R. L. McKee, et al.*

OPINIONS BELOW

The opinion of the Court of Appeals is not yet reported in F.2d but is reported (without a later modification) at 1970 Federal Securities Law Reports ¶ 92,800, and a copy is attached as Appendix A. The opinion of the District Court is reported at 290 F.Supp. 29, and a copy is attached as Appendix B.

JURISDICTION

The jurisdiction of the District Court was invoked under the Investment Company Act of 1940, 15 U.S.C. § 80a-1, et seq. (Act of Aug. 22, 1940, c. 686, Tit. I, § 1, et seq., 54 Stat. 789), and theories of pendent jurisdiction. The Court of Appeals had jurisdiction under 28 U.S.C. § 1291 and 1294(1). Its judgment was dated and entered August 28, 1970 (App. 1). This Court has jurisdiction under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

In any proceeding in a federal court in which a settlement, compromise, or plan of reorganization requires approval by the court, as in class suits under F.R.Civ.P. Rule 23 or derivative suits under Rule 23.1:

1. Is it the correct standard for determining fairness of the proposed settlement to weigh the benefits merely against the claims asserted in the complaint as if those claims were valid and recoverable as prayed? Or must not the court make an appraisal of the claims in order to determine and measure the probabilities of ultimate success if the claims should be litigated and then to weigh the benefits against the chances of success? The courts below held it enough to weigh the benefits against the claims as asserted.

2. Is it requisite to approval of a settlement that it remain executory until approval has been received? That is, if the benefits of the settlement are such that the settlement would deserve approval had it remained executory, is it to be denied approval merely because the party offering the benefits performs his part of the bargain before approval, and the benefits therefore will not be lost even if the settlement is disapproved? The courts below held that if the benefits are conferred before approval, they cease to be consideration supporting the settlement.

RULES INVOLVED

The pertinent provisions are Rules 23(e) and 23.1 of the Federal Rules of Civil Procedure (383 U.S. at 1050):

Rule 23(e):

> "A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs."

Rule 23.1:

> "In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not

be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs."

STATEMENT OF THE CASE

A. The Nature of the Case.

This action is one of the rapidly increasing number of private suits brought in federal courts as class or derivative actions.

The plaintiffs, Lawrence Norman and wife, are investors in an "investment company" or "mutual fund" created by a trust agreement and known as Insurance Securities Trust Fund (the "Fund"). They sued alleging violations of the Investment Company Act of 1940 (15 U.S.C. §§ 80a-1, et seq.) and, under pendent jurisdiction, of California common law. (A copy of the complaint is attached as Appendix C). They alleged that the action was brought "derivatively on behalf of the Fund and representatively on behalf of themselves and all other investors in the Fund" (App. 23).

ISI Corporation ("ISI") is the Fund's sponsor (i.e., the party responsible for bringing it into existence) and also its "investment adviser", its "underwriter", and its "broker".[2] As *under-*

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2. ISI thus performs the functions described at p. 45 of "Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth" (H.R. Rep. No. 2337, 89th Cong., 2d Sess. (1966)):

> "Most mutual funds contract out their principal functions to other organizations that work for them on a fee basis. This 'externalization of management' is the most striking feature of the industry's organizational pattern. The following description of the way in which the funds' most important functions—the selection of investments, the sale of new shares, and the execution of portfolio transactions—are performed delineates the special characteristics of mutual fund structure * * *."

writer ISI is the sales agency that sells participations to the public; for this selling service each participant (investor) pays ISI an agreed salesman's commission, called a "creation fee" (Agreement, Art. VII, § 1(a), R. 27, 28). As *investment adviser* ISI selects the securities in which the Fund invests, and for this service is paid an agreed "advisory fee" (Agreement, Art. VII, § 1(b), R. 28). As *broker* ISI negotiates the purchase and sale of securities bought and sold by the Fund (Agreement, Art. IV, § 1, R. 22-24), and for this service receives a brokerage commission. The agreement states the rate of the creation and advisory fees but not the rate of brokerage.

The complaint alleged that the creation and advisory fees charged by ISI were excessive, and that ISI either had no right at all to charge brokerage or that brokerage was excessive.

Plaintiffs named as defendants the Fund, ISI, the bank (now named Security Pacific National Bank) acting as trustee under the Trust Agreement, the three individual petitioners, they being directors of the Fund and also directors and officers of ISI, and other directors of the Fund unconnected with ISI (Weeth and Draper).

After the suit was commenced plaintiffs engaged as additional counsel Abraham Pomerantz, Esq. of New York, perhaps the most experienced lawyer in the nation in this type of litigation.[3] Following extensive discovery proceedings and negotiations, the parties reached a settlement agreement. By it brokerage commissions were reduced for 10 years to a figure sufficient only to

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3. Mr. Pomerantz's ability, reputation and experience have been frequently commented on by the courts: *E.g. Alleghany Corp. v. Kirby*, 333 F.2d 327, 328 (2 Cir. 1964); *Angoff v. Goldfine*, 270 F.2d 185, 192-3 (1 Cir. 1959); *Josephson v. Campbell*, [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,347 (S.D.N.Y. 1969). In the latter the district court said that Mr. Pomerantz was "able and experienced, particularly in the specific area with which these actions are concerned", and it gave "great weight" to his judgment in approving a proposed settlement of an action brought under the Investment Company Act.

reimburse ISI for its costs of performing the brokerage service, eliminating all element of profit, retroactive to July 1, 1967. The creation fees were reduced, and the basis of calculating advisory fees was changed to accord with the practice of the industry. Thereby ISI essentially conceded, prospectively, all that plaintiffs had sued for, with partial retroactivity as to brokerage. Mr. Pomerantz estimated that the settlement would reduce brokerage commissions by about $10 million, creation fees by about $5 million, and advisory fees by about $3½ million, a total benefit of $18½ million (Pltf. Ex. 1; Tr. 103).

The settlement was presented to the District Court in a Stipulation of Settlement and Compromise, a copy of which is attached as Appendix D (R. 485-508). The court thereupon ordered that "so far as the above-entitled action is not maintainable derivatively on behalf of the Fund or investors as beneficiaries of the Trust, it may and is to be maintained as a class action, the class consisting of all investors in the Fund" (R. 510). As required by F.R.Civ.P. Rules 23(e) and 23.1, the court set a hearing, upon notice to the investors, to determine whether to approve the settlement. More than 176,000 investors were duly notified of the hearing and of their opportunity to object to the settlement or "opt out" of the class (R. 523-39). A number "opted out", but only two objected, respondents Estate of Bumbaugh and Steven Opton, and they became interveners. As Opton also "opted out" of the class (Tr. 77), his standing to object related only to the derivative aspects of the suit. Thus only one investor objected generally.[4]

The District Court invited the SEC to file a brief as *amicus curiae*, and then disapproved the settlement (App. B). From that order *the plaintiffs and all the defendants*, that is, *all the original parties to the cause, appealed to the court below*. Adverse to them

4. A third person, Geerlings, made a limited objection; the Court of Appeals held that he had no standing at all (App. 5)

were the intervenors and the SEC, the latter again appearing as *amicus curiae*.[5]

The Court of Appeals affirmed (App. A).

B. The Basis of the District Court's Action.

1. THE CONCURRENT PROCEEDINGS BEFORE THE SEC.

Nearly a year after this suit had been filed, the SEC's staff instituted formal but private administrative proceedings against ISI to determine whether the charging of *brokerage commissions* violated certain provisions of law.[6] The SEC neither then nor at any other time, before or after, questioned the lawfulness or the amount of the *advisory* or *creation fees*. A month before commencement of the SEC's proceedings, plaintiffs' counsel, Mr. Pomerantz, originated the idea that the brokerage claim should be settled by foregoing future brokerage, in a letter to ISI's San Francisco counsel. Mr. Pomerantz gave a copy of the letter to the SEC as he had given it a copy of the complaint in this case (R. 235-237).

Having ascertained from Mr. Pomerantz's letter the outer boundaries within which a settlement of the lawsuit could be made, ISI proceeded to negotiate with the SEC staff for a settlement of the administrative proceedings on a modification of Mr. Pomerantz's proposal, and embodied this in an offer as the form of negotiation required by dealings with an administrative agency. Then, sensing from discussions with the SEC staff a probability that the proposal might be favorably received, ISI resumed exhaustive negotiations with Mr. Pomerantz. These negotiations and those with the SEC proceeded concurrently. Both the SEC and Mr. Pomerantz knew that ISI would not settle either the lawsuit

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5. We join as respondents here not only the interveners but also the other appellants below, i.e., the plaintiffs and the other defendants, so that all proper parties below are before the Court.

6. When this suit was filed, plaintiffs knew nothing of an interest of the SEC's staff in ISI's brokerage commissions (R. 234).

or the administrative proceedings without concurrently settling the other and on the same basis as respects the common issue of brokerage (R. 272, 234-239, 333-335). Mr. Pomerantz himself kept the SEC advised of the progress of his efforts. Finally, he and ISI reached agreement and reduced it to a definitive writing in December 1967, but Mr. Pomerantz deferred signing it until he could advise the SEC and obtain its reaction. On January 3, 1968, he informed the SEC's Corporate Regulation Division in detail and invited its reaction, which the Staff promised to give him.

ISI's original proposal to the SEC did not provide for the issuance by that body of a cease and desist order; it provided merely for a voluntary reduction of brokerage. But, in response to a suggestion of the SEC's staff that ISI should formally include a provision for a cease and desist order, ISI's Washington counsel on January 9, 1968 presented such an offer to the SEC's Corporate Regulation Division.

Without ever informing Mr. Pomerantz of its reaction to his communication of January 3, and on January 11, 1968, the SEC accepted ISI's offer and issued a cease and desist order against ISI's charging more brokerage than enough to reimburse costs, retroactive to July 1, 1967 (R. 499).

Reference to the settlement with the SEC was then added to the Stipulation of Settlement and Compromise (App. 28, 29), a copy of the SEC's cease and desist order was attached to it as an exhibit (App. 37), and the notice to the investors of the hearing specifically called attention to the SEC's order (R. 525-6). There was thus the fullest disclosure.

2. THE DISTRICT COURT'S REASONING.

As the SEC's brief in the Court of Appeals correctly observed (p. 2), "[t]he district court disapproved the settlement largely for the reasons stated in the Commission's [SEC's] memorandum". There are two striking facts about the SEC's presentation and of the District Court's opinion.

The first is that *neither expressed any views whatever about the merits of the claims asserted in the complaint.* The SEC's amicus brief explicitly stated, "we do not express any views on the merits of plaintiffs' claims" (R. 307). It confined itself to an attempt to determine the benefits to flow from the settlement, saying:

> "We do not think that it would be appropriate for the Commission to comment as to whether there are substantial claims here. * * * For us now to state any views about that question in this context could be considered contrary to the spirit, if not the letter, of that provision of the settlement of the administrative proceeding." (R. 314)

Following the SEC's lead, the District Court nowhere considered, weighed or passed on the merits of any claim asserted in the complaint (all as shown by its opinion, App. B).

No one has ever questioned the correctness of the figure of $10 million as the value of the benefit to the Fund of the provisions of the settlement agreement in this case concerning *brokerage.* In the Court of Appeals, in response to a question from the Bench, SEC's *counsel stated that the giving up of this future brokerage was such substantial consideration that the settlement would have had to be approved, but for the SEC's cease and desist order; in short, that there would have been no rational basis upon which to disapprove it.* But the SEC argued in the District Court that giving up of future brokerage commissions had already been effected by the SEC's cease and desist order of January 11, 1966 and would continue in effect "even if the proposed settlement is disapproved." (R. 321) It urged a supposed principle of the common-law of contracts that an agreement to do what one is already bound to do is not consideration.[7] Later,

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7. Its brief in the District Court appears in full at R. 303-332. At R. 314 it argued: "It is an elementary proposition of contract law—and a settlement is a form of contract—that a promise to do some act in the future is not adequate consideration when the promissor has already committed himself to some third person to do the identical act."

in the Court of Appeals, the SEC disavowed that it was "speaking in terms of technical arguments about the sufficiency of consideration in contract law" and moved over to equitable considerations for the same conclusion (SEC Br. in C of A, p. 28).[8]

Nevertheless, it was upon the reasoning of the SEC's presentation to it that the District Court held the elimination of brokerage to be no consideration for the settlement and therefore ignored it.

The reduction in future *creation fees* worked by the settlement agreement was estimated by plaintiffs to be on the order of $5 million. While suggesting that the value might be less, the SEC's *amicus* brief in the District Court agreed that the settlement would "result in a significant reduction" (R. 294). Nevertheless the District Court entirely ignored this reduction as a relevant factor, and did so solely because the claim relative to creation fees was not derivative, i.e., not a claim of the Fund, but consisted of claims of individual investors, asserted representatively, and it went off on the fact that nothing was being paid to them on account of past creation fees. *But it made no effort to evaluate the claim, to consider whether claim for recovery of creation fees had any merit at all.*

The District Court also entirely ignored as a factor the reduction in future *advisory fees,* assigning the same reason as for ignoring the reduction of creation fees. As with the creation fees, it made no effort to evaluate the merit of the claim. In fact, the claim to the advisory fees was not representative at all. It was derivative; the fees were paid by the Fund and not by the investors; any right of recovery was that of the Fund and not the individual. The SEC agreed that the claim was derivative but argued that it might have "representative aspects" because of the mode of calculation (R. 286).

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8. This it did in response to our demonstration that the SEC's view of technical contract "consideration" was erroneous and our submission that the test of fairness of a proposed settlement turned not on technical rules of consideration but on considerations of equity.

In fact, the claims to advisory fees and creation fees were without any merit at all. No one tried to defend them. The SEC never questioned either fee and told the court it had never "evaluat[ed] the data necessary to offer any meaningful comment." (R. 314) These fees were precisely at the rates specified in the Subscription Agreement each investor signed when he subscribed for a participation (R. 27, 28), the rates stated in the prospectus he received, in the Trust Agreement to which he became a party, and in the proxy statement received annually. Counsel for the only objecting parties, the interveners, advised the court that there was no objection to the creation and advisory fees inasmuch as they were agreed rates (Tr. 291, 292). And never has any suit relative to any investment company resulted in recovery on any claim based on creation or advisory fees.[9] Furthermore, the settlement agreement did not purport to bar the individual claim of any investor who elected not to be a member of the class. If any such person had any right to recover past creation or advisory fees, the settlement did not bar his pursuing the claim. The situation here was thus unlike cases where the time to "opt out" of the class has elapsed before a settlement agreement is reached and comes up for approval or rejection.[10]

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9. In *Kurach v. Weissman*, 1970 Fed. Securities Law Reports ¶ 92,607 (S.D.N.Y. March 13, 1970), the court, approving a settlement over objection of the SEC as *amicus curiae*, observed:

> "The likelihood of success does not appear to be strong. As far as the court has been advised, there has never been a recovery in one of these excessive management fee cases."

Four years earlier, in 1966, the SEC's Report (see fn. 2, supra) stated (at p. 139) that there had been over 50 suits like this, and no plaintiff had prevailed.

10. *Philadelphia Housing Authority v. American Radiator & Standard Sanitary*, 1970 Trade Cas. ¶ 73,346, p. 89,381 at 89,391 (Sept. 24, 1970) notes the distinction:

> "Rather than being in violation of Rule 23, the proposed procedure here avoids the occasional harsh results that have caused criticism of Rule 23(b)(3) class actions. Where a proposed settlement is submitted to the Court for approval after the class has been determined, the rights of claimants who were not even parties to the action

In short, the District Court ignored the values given up by ISI relative to creation fees and advisory fees without any attempt to consider whether there was even a featherweight of merit in those claims. It treated the *mere assertion of the claims as the yardstick against which to measure the adequacy of the benefit of the settlement*. It weighed the benefits against what plaintiffs would recover for the Fund on the derivative claims and what all investors would recover for themselves in the class suit *if* the claims were established to the full extent of the assertion without ever considering whether the claims had any merit or any chance of recovery of even a single penny if litigated.

C. The Basis of the Decision of the Court of Appeals Below.

After devoting most of its opinion to the question whether the order was appealable (and concluding that it was), the Court of Appeals disposed of the merits in 1¼ pages. And half of that was devoted to stating the uncontested principles that a district court is the guardian of absent parties and of the corporate fund, and that it is endowed with discretion. But on the crucial question *whether the District Court applied the correct standards in exercising that discretion*, the court disposed of the case on a standard we submit is as unsound as it is startling (App. 9):

> "Appellants contend that the district judge abused his discretion by failing to directly balance the merits of plaintiffs' claims against the benefits of settlement. We do not agree. Since the exercise of discretion involves essentially a question of fairness, the district judge was entitled to view with more weight the balance *between what plaintiffs sought in their complaint and what the settlement provided.*
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> * * *

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may be forever determined, even if such claimants would prefer to litigate rather than accept the settlement. Here a member of the proposed class will not be so foreclosed; he will still be free to separately litigate his claim if he chooses, even though the settlement is ultimately approved for others in the class."

> "The district judge * * * was entitled to consider *that the prayer for relief was reasonable* and *that the settlement, when compared to the relief sought*, was inadequate."

Thus the Court of Appeals affirmed on the basis that a District Court need do no more than compare *what plaintiffs prayed for in their complaint with the value of the proposed compromise* without attempting to reach a judgment on how likely or remote a recovery would be, simply assuming the prayer to be correct. So holding, the Court of Appeals itself was silent upon the merits of the claims.

Additionally, the Court of Appeals below accepted the reasoning of the District Court that in foregoing future brokerage the settlement gave nothing of value because the brokerage was already foreclosed by the SEC's order.

REASONS FOR GRANTING THE WRIT

We do not ask the Court to grant the writ to determine whether the settlement should have been approved. We pray that it do so to lay down the *correct standards* by which settlements are to be judged. That it do so is important because a flood of cases is pouring into federal courts where settlement requires court approval. That torrent will increase, for several reasons.

In the first place, a line of decisions has had a threefold effect. It has shown that the federal securities acts and similar statutes are the basis of broad development of corporate fiduciary law; it has implied private rights of action from regulatory statutes; and it has shown these new claims to be assertable in class actions and derivative suits. Some of the markers in this development are *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964), *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, *Dasho v. Susquehanna Corp.*, 380 F.2d 262 (7 Cir. 1967), cert. den. 389 U.S. 977, *Esplin v. Hirschi*, 402 F.2d 94 (10 Cir. 1968), cert. den. 394 U.S. 928, *Securities and Exchange Comm. v. Texas Gulf Sulphur Co.*, 401 F.2d 833

(2 Cir. 1968), cert. den. 394 U.S. 976 (1969), and *Escott v. BarChris Construction Corp.*, 283 F.Supp. 643 (1968).

In the second place, the new procedure of F.R.Civ.P. Rules 23 and 23.1, as amended in 1966, has inspired a massive outpouring of class suits. Bills before Congress, such as the proposed Consumer Protection Act, foretell some type of expanded federal class action for consumer protection. It has been said:

> "The class action is mushrooming throughout the courts of our land. * * * Millions of victims of securities frauds, anti-trust violations and an endless variety of consumer wrongs are, thanks to the class action device, now able to gain access to our courts. The court dockets show that they are availing themselves of this opportunity in large, and ever increasing numbers."[11]

Current legal literature is replete with statements such as this, "huge class lawsuits aimed at business or against public officials and institutions are the wave of the future."[12] The new Manual for Complex and Multi-district Litigation gives clear recognition to class actions as a primary source of judicial problems. In all class action and derivative suits, settlement requires court approval.

In the third place, the economic recession threatens a resurgence of bankruptcy and reorganization cases in which court control of settlement is required, *Protective Committee v. Anderson*, 390 U.S. 414 (1968).

It is therefore vital that correct standards and criteria for passing on proposed settlements be made clear. It is not enough to say that a matter lies in the discretion of a trial court or that the court's task is to determine whether a settlement is fair. Discretion does not dispense with proper standards, *Langnes v. Green*, 282 U.S. 531, 541 (1931). The summary disposition of this case by the court below is in error in two respects:

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11. Pomerantz, "New Developments in Class Actions", *25 Business Lawyer* 1259 (April 1970)

12. New York Law Journal, Oct. 15, 1970, p. 4.

1. It enunciates and applies a standard in direct conflict with an applicable decision of this Court and thereby turns approval of settlements into a matter of arbitrary action by a district court.

2. Another standard it applies is in conflict with a decision of the Court of Appeals for the Sixth Circuit and with the evident meaning of Rules 23 and 23.1 of this Court's Federal Rules of Civil Procedure, as respects an important question which has not been but should be settled by this Court.

A. CONFLICT WITH DECISION OF THIS COURT.

The judicial task of passing upon the fairness of a settlement is most aptly likened to weighing in a balance scale, the merits of the claims on one pan and the benefits of the settlement on the other. This Court pronounced that principle in *Protective Committee v. Anderson*, 390 U.S. 414 (1968). The case involved a review of a reorganization plan in a bankruptcy proceeding which compromised various claims of the debtor. This Court reversed an approval of the plan because the District Court had not examined the merits of the compromise claims:

> "There can be no informed and independent judgment as to whether a proposed compromise is fair and equitable until the bankruptcy judge has apprised himself of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated. Further, the judge should form an educated estimate of the complexity, expense, and likely duration of such litigation, the possible difficulties of collecting on any judgment which might be obtained, and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise. *Basic to this process in every instance, of course, is the need to compare the terms of the compromise with the likely rewards of litigation.*"
>
> * * *
>
> "Litigation and delay are always the alternative to settlement, and whether that alternative is worth pursuing necessarily

depends upon a reasoned judgment as to the probable outcome of litigation."

The court below must have thought *Protective Committee v. Anderson* limited to bankruptcy proceedings. It should be made clear that it applies to any proceedings for approval of settlements.

Lower courts have frequently announced the same principle.[13] For example, recently in *West Virgina v. Chas. Pfizer & Co., Inc.*, 1970 Trade Cas. ¶ 73,240, p. 88,897 at page 88,922 (S.D.N.Y. June 24, 1970), the court said:

"H. PRINCIPLES FOR VIEWING THE PROPOSED COMPROMISE

Whether to approve the compromise involves an exercise of discretion. The Court is responsible for the protection of the many class members whose interests are involved but who do not appear in the action. Approval should be given if the settlement offered is fair, reasonable, and adequate. These terms are general and cannot be measured scientifically.

"The most important factor is the strength of the case for plaintiffs on the merits, balanced against the amount offered in settlement. This factor is sometimes referred to as the likelihood of success. The Supreme Court directs the judge

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13. *Glicken v. Bradford*, 35 F.R.D. 144, 152 (S.D.N.Y., 1964):

"We now turn to a consideration of the charges levelled against defendants in the complaint and the defenses and evidence disclosed by them on the hearing with a view to balancing the likelihood of plaintiffs' victory on a trial and recovery of monetary benefits as against the concrete present and future benefits held forth by the settlement without the expense and delay of a trial and subsequent appellate procedures.

"The likelihood of a financial victory by plaintiffs is a consideration which bears heavily on the fairness of the settlement proposed and the absence of collusion or fraud."

Dann v. Chrysler Corp., 198 A.2d 185, 41 Del. Ch. 438 (1963):

"Common sense it seems to me would dictate that where the hope of recovery on the part of the plaintiffs, and thus on the part of the corporation, is small, little can be demanded from the defendants by way of settlement. Certainly this is the case here. * * *"

Philadelphia Housing Authority v. American Radiator & Standard Sanitary, 1970 Trade Cas. ¶ 73,346, p. 89,381, 89,393 (D.C.E.D.Pa., Sept. 24, 1970).

to reach 'an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated' and to 'form an educated estimate of the complexity, expense, and likely duration of such litigation, . . .and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise'. The Supreme Court then emphasizes:

> 'Basic to this process in every instance, of course, is the need to compare the terms of the compromise with the likely rewards of litigation.'

The quotations are from *Protective Committee etc. v. Anderson*, 390 U. S. 414, 424-25 (1968).

"Our Court of Appeals has described this factor as the 'risk and cost of further litigation'. *Neuwirth v. Allen*, 338 F.2d 2, 3 (2d Cir. 1964)."

Of course, a District Court need not attempt to decide the merits of the controversy to the ultimate conclusion it would have to do were the case litigated, for the virtue of a compromise resides in making that ultimate decision unnecessary. But it must examine the merits sufficiently to reach a judgment as to likelihood of success or failure. The fairness of a settlement cannot be measured by comparing the benefits with the size of the plaintiff's demands in his complaint. Not the hugeness of the plaintiff's voice in his prayer but the substance behind his shout is to be placed in the pan of the balance. Baseless claims are often made the subject of suit—if not more so in derivative suits, certainly not less—and slight claims are often bloated.

Here the District Court below did not even purport to examine the claims to evaluate their merits. Neither did the SEC as *amicus curiae*. Neither did the Court of Appeal. The manner in which the District Court proceeded was no more capable of reaching conclusions than one can weigh with a balance scale with one side of the balance missing. If the standard applied by the District Court and sanctioned by the court below is allowed

to stand, approval or disapproval of a settlement becomes a matter of accident and caprice. A defendant would be put to the necessity of first attacking utterly baseless claims by motions for partial summary judgment or for severance and separate trial. The SEC's position below can fairly be summed up thus: The fact that ISI offered benefits of such great magnitude is evidence enough that the plaintiffs' claims are not only meritorious, but so meritorious that what was offered was inadequate! This is not balancing; it is prestidigitation.

We submit that reversal is necessary so that the courts below may perform the balancing process.

B. CONFLICT WITH THE SIXTH CIRCUIT.

The courts below entirely removed from the balance scale the $10 million of benefits from reduction of future brokerage, simply because the same reduction was embodied in the stipulated settlement with the SEC. Thereby those courts construed Rules 23 and 23.1 as applying only to compromise agreements that are entirely *executory*, that is, where performance by the defendant of what he agrees to give has been held in abeyance until after approval by the court. One who gives performance of his promise before court approval runs a risk that approval may be denied so that he may end up receiving nothing for his payment. But performance in advance cannot be a basis for disapproval, on the theory that what has been given is given, that the benefits have been received and will be kept whether or not the settlement is approved. Whether the promise has been executed or is still executory, the question remains the same: Is the compromise fair? If it would be held deserving of approval if yet unperformed, it should be approved even if executed before approval.

In *Masterson v. Pergament*, 203 F.2d 315 (6 Cir. 1953), the court affirmed *Pergament v. Frazer*, 93 F.Supp. 13 (E.D.Mich. 1950), approving a settlement of a stockholder's derivative suit

involving nine transactions. The District Court first appraised the probability of recovery and concluded that there was little probability in six of the nine transactions. It then said:

> "This brings us to the final questions for this court to determine which are centered about the one word 'consideration', i.e., just what is the consideration, if any, to be paid by defendants according to the proposed agreement and is it sufficient as a compromise to satisfy the probable value of these several stockholders' derivative suits?" (p. 24)

The alleged consideration consisted of payment of $500,000 and the agreement of Henry J. Kaiser Co. and Kaiser Company, Inc. to give to the Reconstruction Finance Corporation a guaranty of $15,000,000 on a loan to Kaiser-Frazer and to pledge $10,000,000 in collateral. There was evidence that the giving of these guaranties was worth between $3,500,000 and $20,000,000. *However, without waiting for the settlement to be submitted to the court for approval, Kaiser Company had given the guaranty.*

> "We come then to the final objection raised by the objecting stockholders—that part of this consideration had already been paid when the first notices went out to the stockholders which makes it a 'fait accompli' and cannot be accepted as consideration of an agreement 'in futuro'." (p. 27)

The court overruled the objection and said:

> "The Kaisers were caught between two fires and as soon as they knew the agreement was signed they quickly gave the guaranties and Kaiser-Frazer got the money from RFC. [p. 27]
>
> * * *
>
> "But we do not understand that the purpose of Rule 23(c) is properly construed by objecting stockholders as applying only to agreements that are entirely executory. As a matter of fact, we believe that *those who were responsible for this rule had no such limitation in mind.* But whether they did or did not, *this Court is not going to lay down the rule that*

directors of corporations who may in the future be charged with breach of trust or fraud and who may be confronted with a situation that requires immediate action *must not under any circumstances do what they honestly believe to be the proper thing until the court has had an opportunity to determine whether the agreement of compromise they may have entered into is good or bad.* [pp. 27-28]

* * *

"To this court *it is an accepted principle of law that we may sanction an act which we would have authorized in advance of its performance.*

"Furthermore, it has been the rule for years that if a settlement is worthy of approval it is immaterial whether some or all of the benefits may already have been conferred pursuant to the agreement." [Citations omitted.]

It is this Court that was "responsible for this rule", and it should confirm that the rule means what *Pergament* say it means.

ISI's negotiations for settlements with plaintiffs and with the SEC on the same terms as to brokerage were concurrent. Its offer to the SEC was nothing but a mode of negotiation. The agreement between ISI and plaintiffs had already been reached by December 1967, and its substance had been reduced to writing and merely awaited signature, all before the SEC's order. No law required that the agreement be placed in writing in order to be an agreement, although the mechanics of presenting it for approval necessitated that step. ISI's action thereafter, January 9, 1968, making the final amendment to its offer to the SEC, and in allowing it to be accepted on January 11, 1968, *constituted performance of its agreement with plaintiffs to reduce brokerage.* By allowing the SEC order to issue, ISI simply converted its executory agreement with plaintiffs into an executed one.

In the *Pergament* case, the "Kaisers were caught between two fires" and performed before approval in order to quench one. The same was true here. The SEC proceedings were based upon the Investment Company Act of 1940. That act expresses no

private right of action but vests enforcement authority in the SEC, but the existence of a private right of action was sought to be implied. The two assailants based their attack against ISI upon the same statute and the same facts. This situation is not an isolated event. It is certain to be a commonplace in American corporate life. Whenever the SEC institutes proceedings against someone subject to its jurisdiction under federal securities acts, private parties will bring suit in a federal court on the same facts and the same law. Settlement of controversies is always a desideratum. But the principles espoused by the SEC below, and accepted by the two courts, woefully handicap possibility of settlement of concurrent claims of regulatory agencies and private parties based on the same acts and facts.

The SEC itself concluded that it was a fair disposition of the brokerage issue for ISI to render brokerage services at cost in the future with retroactive effect only to July 1, 1967, and it conceded (p. 9 supra) that if ISI had carried the settlement to court before consummating its offer to the SEC, the court would have approved. As that disposition was fair when the SEC approved it on January 11, 1968, it was fair when plaintiffs and ISI agreed to it the *previous* fall and winter. Fairness does not ask whether one party has let the pawl be set on the ratchet so as to be subject to another turn of the screw to squeeze out another pint of blood.

The Court of Appeals disposed of this subject in three sentences, explicable only as an imperfect response to an argument presented to it, not by ISI, but by plaintiff's counsel. Mr. Pomerantz urged that the settlement involved a "triangular agreement" among the plaintiffs, SEC and ISI, basing his argument on his personal communications with the SEC staff and everyone's knowledge that ISI would not settle one proceeding without settling the other. Responding to this argument the Court of Appeals said (App. 9):

> "Appellants also argue that the proposed settlement should have been accepted because a triangular understanding existed between the parties to this suit and the SEC that both actions would be settled on the same terms. We do not think that the district judge abused his discretion by not accepting the settlement on this basis, especially in view of his findings that the settlement with the SEC was broader than the proposed settlement of this suit and that the proposed settlement waived plaintiffs' claims to restoration of any part of the alleged excess fees. He was entitled to consider that at least some unnamed plaintiffs did not have such an understanding since certain of them appeared in opposition to the settlement."[14]

Evidently interpreting Mr. Pomerantz as arguing that there was a formal three-party contract, the court rejected the argument as being factually incorrect.

A grievous injustice has been perpetrated on ISI. It has forever given up $10 million of brokerage; yet it is told that it must still litigate this lawsuit. So it was told by the District Court on the basis of some assumed technical contract rule of "consideration", a ground disavowed by the SEC's brief in the Court of Appeals. So it was told by the Court of Appeals on the basis that the District Court was entitled to "exercise discretion". We respectfully submit that a gross distortion of F.R.Civ.P. Rules 23 and 23.1 has been worked. That distortion can only serve to chill settlement attempts in like litigation.

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14. The last sentence in the quoted passage is mystifying. By "unnamed plaintiffs" the court could have only referred to *nonplaintiff members* of the investor class. Since such persons had not participated in the negotiation of the settlement and learned of it only when advised by the notice of the hearing, their "understanding" of the settlement could have no relevance to what it was. Moreover, the "certain of them" who appeared in opposition were only two, Opton and the Estate of Bumbaugh.

CONCLUSION

We respectfully submit that the writ should be granted to settle correct standards for judicial supervision of settlements in derivative and class actions and like proceedings.

Dated: San Francisco, California, November 18, 1970.

MOSES LASKY

Attorney for Petitioners

Of Counsel:
CHARLES B. COHLER

Appendix A

United States Court of Appeals
for the Ninth Circuit

Lawrence and Elizabeth Norman, *Plaintiffs-Appellees,* vs. R. L. McKee, et al., *Defendants,* R. L. McKee, E. R. Foley, Elwood Murphy, and Insurance & Securities Incorporated, *Defendants-Appellants.*	No. 23,489
Lawrence and Elizabeth Norman, *Plaintiffs-Appellees,* vs. R. L. McKee, et al., *Defendants,* W. W. Weeth, W. H. Draper, Jr., and Pacific National Bank of San Francisco, *Defendants-Appellants.*	No. 23,548
Lawrence and Elizabeth Norman, *Plaintiffs-Appellants,* vs. R. L. McKee, et al., *Defendants-Appellees.*	No. 23,582

Appeal from the United States District Court
for the Northern District of California

Before: Browning and Hufstedler, Circuit Judges, and Battin*, District Judge.

*Honorable James F. Battin, United States District Judge for the District of Montana, sitting by designation.

BATTIN, District Judge:

This is an action against Insurance Securities Trust Fund (hereinafter the Fund), its directors and officers, its trustee, Pacific National Bank, and its underwriter and manager, Insurance and Securities Incorporated (hereinafter ISI). Plaintiffs have been investors in the Fund since 1963. They bring the action derivatively on behalf of the Fund and representatively on behalf of all other investors. The Fund has approximately 175,000 investors. Jurisdiction is invoked under the Investment Company Act of 1940, 15 U.S.C., Section 80, *et seq.*

BACKGROUND OF THE CASE

ISI is the organization responsible for bringing the Fund into existence. It performs three important functions for the Fund: The selection of investments, the sale of new shares, and the execution of portfolio transactions. For the function of investment advisor and manager, it receives a "management" or "advisory" fee. The complaint alleges that this fee for the fiscal year ending in 1965 was $5,369,282. For selling shares, ISI receives a salesman's commission or "creation" fee. For the fiscal year ending in 1965, the complaint alleges that this fee amounted to $11,539,666. For executing portfolio transactions, ISI receives a brokerage fee. For the years 1962 through 1965, it is alleged to total $3,772,000. The total of the fees for the years alleged is $20,680,948. The complaint alleges that the management and creation fees were and are excessive and that ISI has no right to charge any brokerage commission or, in the alternative, that the brokerage commissions were and are excessive. The complaint prays for recovery of the excessive fees.

After extensive discovery, plaintiffs and defendants negotiated a settlement. The settlement provided for a new schedule of management fees at lower rates to be applicable for a ten-year period. The creation fee on new investments would be reduced

for ten years from 8.45% of the sale price of a new certificate to 8.8%. The settlement provided that brokerage commissions received after July 1, 1967, would be restored to the Fund so far as those charges exceed ISI's cost of performing brokerage service and that brokerage service for a period of ten years would be performed at cost. Because the suit was brought both derivatively and as a class action, court approval of the settlement was necessary under Rules 23.1 and 23(e), F.R.Civ.P. The district court issued an order to show cause why the settlement should not be allowed and notice was given to the investors in the Fund. Hearings were held in April and May, 1968. At least two investors appeared in opposition to the settlement. Before concluding the hearings, the court invited a statement from the Securities and Exchange Commission which responded by filing a brief as *amicus curiae*. By order dated July 29, 1968, the district court ordered "that the proposed settlement, as now presented, be disapproved." The named plaintiffs and defendants appealed. Appellees are investors who appeared in opposition to the settlement.

The district judge found that the proposed settlement was "so inadequate, and, therefore, so unfair that it should not receive judicial approval." With regard to the management fees, plaintiffs predicted that the new schedule would reduce such fees by about $3.5 million over the ten-year period. The new schedule would be applicable only to new certificates. The district court reasoned, therefore, that only future investors would benefit from the new schedule and not the present investors who sought recovery of excess management fees. The creation fee was charged on the sale of a new certificate or the reinvestment of a matured certificate in a new certificate. Plaintiffs predicted that the new rates in the settlement would reduce such fees by $5 million over the ten-year period. Before the settlement offer was made, the SEC adopted a rule prohibiting creation fees when the pro-

ceeds of a matured certificate are reinvested in a new certificate. The district court reasoned that ISI's offer to waive reinvestment creation fees in the future was no consideration, and that, with regard to new investments, the settlement would not benefit the present investors who sought to recover excessive creation fees. Further, as to both management and creation fees, the court pointed out the view of the SEC that such fees were not charged against the Fund but are paid by an investor when he purchases a certificate. Since the settlement waived claims for past improper charges, it would not benefit former and present investors who had already paid the fees and who may seek to recover the excessive fees in an individual action.

Approximately one month before the settlement here was proposed to the court, the SEC and ISI reached a settlement of an action pending before the SEC. With regard to brokerage fees under that settlement, ISI was ordered to refund the amount of fees charged after July 1, 1967, and to begin performing brokerage services at cost for an indefinite time. The district court found that the settlement of brokerage fees did not benefit the Fund or its investors since ISI had only offered to do for ten years what the SEC had already ordered it to do indefinitely.

Two questions are presented by this appeal: (1) Whether an order disapproving a proposed settlement of a class action or a stockholder's derivative suit is appealable as a "final" order, and (2) whether the district judge abused his discretion in disapproving the settlement. We hold that the order is appealable and that the district judge acted within the bounds of his discretion.

APPEAL

Paul F. Geerlings, an Appellee, filed a motion to dismiss the appeal. Appellants ISI, McKee, Foley, and Murphy argue in their brief that Geerlings has no standing to appear against

ISI since he was employed as ISI's Associate General Counsel while this suit was pending. We agree. Appellants point out that Geerlings was not only aware of this suit when he acted as an attorney for ISI, but he represented ISI on matters specifically relating to this case. He is now using the knowledge he gained through an attorney-client relationship against his former client. Certainly he could not appear on his own behalf against ISI. *Chugach Electric Association vs. U. S. District Court,* 370 F.2d 441 (9 Cir. 1966). To allow him to appear through his attorney would be to allow him to do indirectly what he cannot do directly. Holding that Geerlings does not have standing to appear against ISI, however, does not mean that the question of appealability must be disregarded. Since appealability relates directly to our jurisdiction, it is "encumbent upon us to ascertain whether the order of the district court is final and appealable." *Budke vs. Kaiser-Frazer Co.,* 275 F.2d 217, 219 (9 Cir. 1960).

Under Title 28 U.S.C., Section 1291, the courts of appeals have jurisdiction of appeals "from all final decisions" of United States district courts. The historic policy, and the concept of finality on which Appellees rely, is that a "final decision" is one which ends the litigation on the merits and leaves nothing for the court to do but execute the judgment. *Catlin vs. U. S.,* 324 U.S. 229, 65 S.Ct. 631, 89 L.Ed. 911 (1945); *Cobbledick vs. U. S.,* 309 U. S. 323, 60 S.Ct. 540, 84 L.Ed. 783 (1940). Despite its apparent simplicity, however, this definition has not proved workable in all situations. The Supreme Court conceded long ago that the cases on finality "are not altogether harmonious", *McGourkey vs. Toledo & Ohio Central Railway Co.,* 146 U.S. 536, 545, 13 S.Ct. 170, 36 L.Ed. 1079 (1892), and the court stated more recently that it "cannot devise a form of words that will settle this recurrent problem." *Dickenson vs. Petroleum Conversion Corp.,* 338 U.S. 507, 508, 70 S.Ct. 322, 94 L.Ed. 299 (1950).

One group of cases in which the question of finality was considered involves what the Supreme Court has termed "collateral orders." A collateral order is an offshoot of the principal litigation which is immediately appealable as a "final decision" because of the practicalities of the litigation and because it disposes of a matter separate from the merits of the case. The leading case for allowing appeal of a collateral order is *Cohen vs. Beneficial Industrial Loan Corporation*, 337 U.S. 541, 69 S.Ct. 1221, 93 L.Ed. 1528 (1949). That case was a stockholder's suit in which the defendant corporation moved under New Jersey law to require plaintiff to post security for defendant's costs. The motion was denied. In holding that the order denying the motion was appealable, the Supreme Court said at 337 U.S. 546:

> "This decision appears to fall in that small class which finally determines claims of right separate from and collateral to rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated."

The Supreme Court, citing *Cohen, supra*, reiterated its practical approach to the question of finality in *Gillespie vs. U. S. Steel Corporation*, 379 U.S. 148, 85 S.Ct. 308, 13 L.Ed.2d 199 (1964). *Gillespie* was a Jones Act case where the district court struck portions of the complaint including the parts relating to recovery for persons other than the decedent's mother. In allowing the appeal from that ruling, the Court stated at 379 U.S. 153:

> "It is true that the review of this by the Court of Appeals could be called 'piecemeal'; but it does not appear that the inconvenience and cost of trying this case will be greater because the Court of Appeals decided the issues raised instead of compelling the parties to go to trial with them unanswered. We cannot say that the Court of Appeals chose wrongly under the circumstances. And it seems clear now that the case is before us that the eventual costs, as all the parties recognize, will certainly be less if we now pass on the questions presented here rather than send the case back with

those issues undecided. Moreover, the delay of perhaps a number of years in having the brother's and sister's rights determined might work a great injustice on them, since the claims for recovery for their benefit have been effectively cut off so long as the District Judge's ruling stands."

The meaning of the term "collateral" was set out by the Supreme Court in *Mercantile National Bank at Dallas v. Langdean*, 371 U.S. 555, 83 S.Ct. 520, 9 L.Ed.2d 523 (1963). In that case the Texas Supreme Court overruled objections to venue of an action where the action was brought in a venue proper under state law although a federal statute arguably required suit to be brought elsewhere. The Court allowed the appeal, saying at 371 U.S. 558:

> "This is a separate and independent matter, anterior to the merits and not enmeshed in the factual and legal issues comprising the plaintiff's cause of action."

In *Cohen, supra*, at 337 U.S. 546, the Supreme Court spoke of the order denying security for costs as an order which "did not make any step toward final disposition of the merits of the case and will not be merged in final judgment." It seems clear in this case that the order disapproving the proposed settlement is a collateral order. The proposed settlement is independent of the merits of the case. It would not merge in final judgment. Disapproval of the settlement is not a step toward final disposition and it is not in any sense an ingredient of the cause of action. In itself, the district judge's order is final on the question of whether the proposed settlement should be given judicial approval.

The ultimate balance on the question of finality, as the Supreme Court stated in *Dickinson vs. Petroleum Conversion Corp.*, 338 U.S. 507, 511, 70 S.Ct. 322, 94 L.Ed. 299 (1950), is between "the inconvenience and costs of piecemeal review on the one

hand and the danger of denying justice by delay on the other." As a practical matter, stockholder's derivative suits and class actions generally present complex questions and involve large numbers of exhibits and witnesses. The present case is a good example. The trial would be lengthy and expensive. In this situation, therefore, we think that the cost and delay of piecemeal review, as balancing factors, are diminished in importance. The named plaintiffs, as representatives of a class under Rules 23.1 and 23(e), F.R.Civ.P., have a strong duty to fairly and adequately represent the interests of the class. Considering again the length of trial in such cases, the right of the unnamed plaintiffs to fair representation may be infringed by the erroneous disapproval of a settlement. To those parties, the disapproval of a settlement would only delay justice. We think that the inconvenience of piecemeal review of an order disapproving a settlement is outweighed by the danger of denying justice by delay. We hold, therefore, that orders disapproving settlements under Rules 23.1 and 23(e), F.R.Civ.P., are appealable as final decisions under Title 28 U.S.C., Section 1291.

DISAPPROVAL OF THE SETTLEMENT

Rules 23(e) and 23.1, F.R.Civ.P., provide that an action brought under those rules "shall not be dismissed or compromised without the approval of the court." The reason for the requirement is obvious. Because the rights of many persons are at stake who are parties to the action only through their representative, a settlement negotiated between the named parties may not give due regard to the interests of those unnamed. *Cohen vs. Young*, 127 F.2d 721 (6 Cir. 1942). The question for the district judge is whether the proposed settlement is fair and adequate to all concerned. The question on appeal here is whether the district judge abused his discretion in denying the proposed settlement.

Appellants contend that the district judge abused his discretion by failing to directly balance the merits of plaintiffs' claims against the benefits of settlement. We do not agree. Since the exercise of discretion involves essentially a question of fairness, the district judge was entitled to view with more weight the balance between what plaintiffs sought in their complaint and what the settlement provided. Appellants also argue that the proposed settlement should have been accepted because a triangular understanding existed between the parties to this suit and the SEC that both actions would be settled on the same terms. We do not think that the district judge abused his discretion by not accepting the settlement on this basis, especially in view of his findings that the settlement with the SEC was broader than the the proposed settlement of this suit and that the proposed settlement waived plaintiffs' claims to restoration of any part of the alleged excess fees. He was entitled to consider that at least some unnamed plaintiffs did not have such an understanding since certain of them appeared in opposition to the settlement.

The district judge properly understood that his responsibility was to act as guardian of the absent parties and the corporate fund as a whole. As such, he was entitled to consider that the prayer for relief was reasonable and that the settlement, when compared to the relief sought, was inadequate. To hold that no consideration existed for part of the settlement was also proper when the SEC settlement was compared to the proposed settlement of this suit. In short, we find that the district judge did not act arbitrarily or unreasonably under all the circumstances presented by this case. He acted entirely within the bounds of his discretion.

The judgment of the district court is affirmed.

United States Court of Appeals
for the Ninth Circuit

Nos. 23489, 23548, 23582

Lawrence and Elizabeth Norman,
Plaintiffs-Appellants-Appellees,
vs.
R. L. McKee, E. R. Foley, Elwood Murphy, Insurance & Securities Incorporated, W. W. Weeth, W. H. Draper, Jr. and Pacific National Bank of San Francisco,
Defendants-Appellants-Appellees.

Upon reconsideration of the opinion in the above-entitled cause,

It Is Ordered that the opinion filed August 28, 1970, be and hereby is modified by striking the following sentence from the third full paragraph on Page 4 of the slip opinion:

"He is now using the knowledge he gained through an attorney-client relationship against his former client."

I hereby certify that Judges Browning, Hufstedler and Battin have concurred in the above order. The clerk will please file.

/s/ JAMES F. BATTIN
United States District Judge
Sitting on the Circuit Court
by designation

Dated September 30, 1970

Appendix B

United States District Court
Northern District of California

No. 45079

Lawrence Norman and Elisabeth Norman,
Plaintiffs,

vs.

R. L. McKee, et al,
Defendants.

MEMORANDUM OF DECISION

SWEIGERT, J.

This suit was commenced on May 9, 1966, by the named plaintiffs, Lawrence Norman and Elizabeth Norman, his wife, as investors since 1963 in Insurance Securities Trust Fund against the Fund (which has approximately 175,000 investors); its directors and officers, its Trustee, Pacific National Bank, and its underwriter and manager, Insurance Securities Incorporated (hereinafter referred to as ISI) derivatively on behalf of the Fund and representatively on behalf of all other investors. Jurisdiction of this Court is invoked under the Investment Company Act of 1940 (15 U.S.C. § 80(a) et seq).

The complaint alleges in substance and effect that the defendants, acting in violation of the Act, improperly charged the Fund (a) with brokerage commissions totaling $3,772,000 during the fiscal years ending June 30, 1962, 1963, 1964 and 1965; (b) with advisory fees amounting to $5,369,282 during the fiscal year ended June 30, 1965; and (c) with net creation fees amounting

to $11,539,666 during the same period. The complaint prays that the defendants be required to account for and restore to the Fund these alleged improper charges, totaling in all over 20 million dollars, and further that defendants be required to pay plaintiffs their costs of suit including reasonable attorneys' fees.

The case comes before the court at this time pursuant to a previous order made under Rules 23(a) and 23.1 Fed. R. Civ. P., and dated and filed herein February 21, 1968, requiring all investors in the Fund, as members of the represented class, to show cause on April 3, 1968, why a certain Stipulation and Settlement and Compromise entered into between the named plaintiffs and the defendants and filed and dated herein February 21, 1968, should not be approved by the court and a judgment entered herein accordingly and binding on all members of the represented class who have not noticed their exclusion as permitted in Rule 23.

The matter came on regularly for hearing on April 3, 1968, at which time certain of the represented class appeared to oppose approval of the settlement, among whom were Alma Meyers and Myrtle G. Cromwell, as executrices of the Last Will of Ethel I. Baumbaugh, deceased, a member of the represented class until her death on March 29, 1967. Further hearings were held on April 4th, April 30th, May 24th and the matter was submitted for decision as of June 7, 1968.

During the hearings affidavits of the parties to the action and of appearing members of the class were received, some oral testimony taken and argument was heard. Further, on April 8, 1968, the court, acting on its own motion, requested the Securities and Exchange Commission to appear as amicus curiae. The Commission did so appear through its General, Associate and Special Counsel, by Memorandum filed herein on May 22, 1968.

All parties to the suit and appearing members of the class were given full opportunity to respond to said SEC Memorandum

by oral argument, written briefs and further affidavits, the responding briefs of the named plaintiffs herein and of the defendants herein being filed herein as of May 22nd and May 21st, respectively.

The court agrees with the named plaintiffs and the defendants to the extent of their argument that the court should not lightly disapprove a compromise of litigation.

However, settlement of a derivitive[sic] and representative suit affects, not only the rights of those actually before the court, but also the rights of many persons not present to speak for themselves. Rules 23(a) and 23.1 place the court in the role of a third party to the compromise or guardian of the absent parties and of the corporate fund as a whole. The absence or silence of investors does not relieve the judge of his duty and, in fact, adds to his responsibility.

The burden is on the proponents of the settlement to show that the settlement is fair and reasonable, having in mind the likely results of the litigation as compared with the consideration received for not going forward with it.

Although compromise, generally speaking, is to be encouraged, and the practical judgment of the named parties advised by competent counsel is entitled to considerable weight, and although the court should not simply substitute its practical judgment for that of the parties, the court, nevertheless, should not approve a settlement which appears on its face to be so inadequate and, therefore, so unfair to the corporate fund or represented class as not to merit judicial approval. With this in mind we examine the various aspects of the proposed settlement.

THE BROKERAGE FEE ISSUE

The proposed stipulated settlement provides that ISI will restore to the Fund amounts charged by it as brokerage commissions from and after July 1, 1967, so far as those charges exceed ISI's

own costs of performing brokerage service—an amount stipulated to be $618,286.72—and, further, that hereafter ISI will itself perform all services in connection with the sale or purchase of portfolio for the account of the Fund at a charge no greater than ISI's own costs of performing such service—such costs to be determined according to a prescribed formula—and, further, that this arrangement will remain in effect for a period of ten years.

It will be noted that under the proposed settlement no part of the brokerage fees charged against the Fund by ISI prior to July 1, 1967 is to be restored to the Fund.

According to the record (See SEC Order of 1/11/68, p. 7, as appended to the Stipulation for Settlement and Compromise filed 2/21/68) brokerage commissions charged by ISI against the Fund amounted to more than six million dollars during the fiscal years 1959-1967. Plaintiffs' complaint, filed May 9, 1966, alleged the amount to be $3,772,000 during the fiscal years 1962, 1963, 1964 and 1965, apparently upon the theory that recovery would have to be limited by the four year statute of limitations. Adding brokerage fees charged after the filing of suit, the total would be over five million dollars.

Assuming the propriety of offsetting against this amount in favor of ISI its actual costs of performing brokerage services,* the recoverable amount of "profit" on the brokerage fees would still be not less than $2,771,307, according to counsel for the named plaintiffs (see Plaintiffs' Brief of 5/22/68, p. 15) and $1,750,000, according to defendants (see Defendants' Brief of 5/21/68, p. 15).

Counsel for the named plaintiffs express the belief (Plaintiffs' Brief of 5/22/68, p. 10) that giving up of claims for restoration

*The propriety of allowing any such offset in favor of ISI is debatable. The Division of Corporate Regulation and Trading and Markets of the SEC took the view that ISI was not justified in charging the Fund a brokerage fee in addition to its regular management fee. (See SEC Order of 1/11/68, p. 8).

of $2,800,000, past "profit" made by ISI on over five million dollars of brokerage commissions charged against the Fund during the limitations period prior to July 1, 1967, is justified by the fact that the settlement, which obligates ISI to refrain for 10 years from charging the Fund for brokerage services (beyond its actual costs) will eventually benefit the Fund to the extent of an estimated ten million a year, i.e., one million a year over a future 10 year period.

The difficulty with this argument is that the Securities Exchange Commission, as early as August 5, 1964, nearly two years before the commencement of this suit, had issued a formal order directing its staff to investigate the ISI practice of charging the Fund with brokerage commissions and had followed through in March 6, 1967, with a private administrative proceeding against ISI to determine whether the charging of these commissions violated the anti-fraud provisions of the Securities Acts or the Investment Advisory Act of 1940. This latter proceeding eventually resulted in the SEC Order of 1/11/68 already mentioned herein.

That Order sets forth a stipulation (p. 2-7) of the facts concerning brokerage commissions charged to the Fund by ISI between 1959 and 1967; also a statement of the reasons (p. 8) for the SEC Division of Corporate Regulation and Trading and Markets determination that it was unjustifiable for ISI to charge the Trust Fund brokerage commissions in addition to the so-called management fee provided in the basic Trust Agreement.

The Order then recites that, although ISI denies any violation of the federal securities laws, it has offered to discontinue, retroactively to July 1, 1967, charging any amounts in excess of its actual administrative cost of the brokerage services performed for the Fund and has consented to the entry of a cease and desist order to that effect—provided the SEC will refrain from making any findings as to whether its past practices violated the federal securities laws.

The Order then recites that the Commission accepts this offer, despite this limitation,* "in view of the unique circumstances of this particular situation and the benefits which will result to the shareholders of the Fund from a prompt disposition of the matter", it being understood, however, that the Commission's acceptance of the ISI offer "in no sense implies that we are persuaded that the activities engaged in, as set forth in the stipulation of facts, did not violate the federal securities laws or that we in any way condone them."

The SEC Order became effective as of January 11, 1968, more than a month before the signing of the proposed settlement of this suit, and will continue in effect retroactively from July 11, 1967 and indefinitely for the future even if the proposed settlement of this suit is disapproved.

It is clear, therefore, that the proposed settlement of this suit on terms of estimated *future* saving to the Fund (retroactive only to July 1, 1967) does not confer any significant benefit on the Fund, its present investors or those who were investors at the time of the alleged violations that has not already been conferred by the SEC cease and desist order.

We are not impressed with the attempt of counsel or the named plaintiffs to present the in futuro terms of the proposed settlement of this suit as better than the SEC Order. In fact, it would seem that in certain respects the SEC Order is better because (1) it continues indefinitely while the proposed settlement is limited to 10 years, and (2) it places an absolute limit on the amount of brokerage costs chargeable by ISI to $350,000 in the years 1968, 1969 and 1970.

Admittedly, the proposed settlement—except for $618,285 ISI profits in brokerage commissions charged since July 1, 1967—waives plaintiffs' claim for restoration of any part of the five

*One of the five members of the Commission dissented on the ground that the Commission should not preclude itself from making findings concerning legal violations.

million dollar brokerage fees charged against the Fund during the 4 year period prior to commencement of this suit and thereafter through 1967.

Just why under these circumstances the named plaintiffs have joined in a presentation to the court of the proposed settlement is not clear.

Counsel for the named plaintiffs do not suggest any weakness in the legal or factual basis for their claim for restoration of the brokerage fees. On the contrary, they say in their Brief of 5/22/68, p. 9: "Contrary to Mr. Lasky we have always regarded the brokerage claims as a very good cause of action with an excellent prospect of recovery".

It appears from the record that before, on and after the date of the SEC Order, the named plaintiffs were just as free to act appropriately for the benefit of the Fund and the class they claim to represent as was ISI free to settle the SEC proceeding against it on terms considered to be in its own interest.

THE MANAGEMENT FEE ISSUE

For its services, including administration, management and investment advice, ISI charges a so-called "Management Fee" of 1½% per year of the face amount of each outstanding investment certificate.

The complaint alleges that ISI, acting in violation of the Act, received management fees of $5,369,282 from the Fund in the fiscal year ended June 30, 1965 and continues to receive such and, further, alleges that such fees were excessive. The complaint prays recovery of the excessive management fees.

The proposed settlement provides that ISI will attempt to effect an amendment providing a new management fee schedule which will be applicable for 10 years after any such amendment. Such new schedule will be applicable, however, only to new investment certificates sold after the amendment. The new schedule will be such that, if it had been applicable to all certificates

outstanding in 1967, the management fees of ISI during that year would have been at least $700,000 less than those actually received.

Plaintiffs predict that this new schedule will reduce management fees, as compared to present management fees, by about $3,500,000 over the 10 year period.

It will be noted, however, that since the new schedule will be applicable only to investment certificates sold in the future, there will be no change, nor any saving, with respect to management fees chargeable to investment certificates now outstanding—whether they were held during the period of alleged excessive management fee charges or not. Thus, a new schedule can benefit only such of the general public as might invest in the future, or perhaps, some present investor who might purchase an additional new certificate in the future.

As a matter of fact, the proposed settlement provision for a new schedule is broad enough to permit a schedule on a net asset value basis (as distinguished from the present contract-price basis) under which even new investors in the future could be no better off as far as the management fee is concerned, than under the fee schedule applicable to all investors in the past.

Here again the proposed settlement waives plaintiffs' claim to the alleged $5,369,282 collected by ISI during the fiscal year 1965 and management fees thereafter collected by ISI.

CREATION FEE ISSUE

ISI charges and deducts from all payments on the sale of a new certificate a so-called creation fee of 8.85%. Similarly it charges and deducts this creation fee on the reinvestment of the proceeds of a matured certificate in a new certificate.

The complaint alleges that ISI received, in violation of the Act, $11,539,666 in creation fees during the fiscal year ended June 30, 1965, and continues to receive them. The complaint

also alleges that these fees were excessive and prays for restoration of the excessive fees.

First, with respect to creation fees on *re*investment the proposed settlement merely provides that ISI will not for 10 years increase reinvestment creation fees beyond the rates fixed by certain agreements made by ISI under which ISI waived creation fees for some reinvestments and reduced the fee to 5% on others. Further, on August 12, 1967, SEC adopted a Rule 11a-1 (17 CFR 270.11a-1) which now prohibits creation fees on reinvestment of the proceeds of matured certificates. It appears, therefore, that the proposed settlement, so far as *re*investment creation fees are concerned, does not provide any observable benefit for the Fund or its investors—past, present or future.

As to creation fees on *new* investments, the proposed settlement in effect reduces for 10 years the creation fee charge from 8.85% to 8.5%. Plaintiffs predict a saving, as compared with such charges in the past, of 5 million dollars over the 10 year period.

This saving, however, will not benefit the Trust Fund (which does not, itself, pay the creation fee) or existing investors—whether they became such during the period of alleged excessive creation fees on new investments or not. The savings will inure to the benefit only of such of the general public as might make new or additional investments in ISI.

PAST INVESTORS

SEC argues that, when fees, including the brokerage fees here in issue, have been illegally collected over a long period from a mutual fund having the characteristics of the Fund here involved, those who were investors at the time the illegal fees, including the brokerage fees, were collected, but who have since disposed of their investment, have a right, recognizable in equity, to share in any recovery as well as the Fund itself, or investors at the time of the restoration or those who become investors thereafter.

SEC points out that the creatoin fees were collected by ISI from each investor by deducting the percentage from payments made on his investment. Thus, the creation fees were in the nature of commissions paid to ISI by the individual investors and any claim of illegality of such commissions would be the investors' direct personal claim rather than a claim of the Fund itself.

Similarly, SEC points out that although the management fees were charged against the Fund's income or assets, they were separately computed on the basis of each investor's agreement and the amount deducted therefrom. Accordingly, it appears, therefore, that the claim for illegally charged management fees could also be treated as a claim of the investors rather than a claim of the Fund.

As to the brokerage commissions collected by ISI, the SEC recognizes that these fees were charged against the assets of the Fund rather than against the accounts of the individual investors. It argues, however, that in view of the unique nature of the Fund here involved and the certificates therein, investors who were such at the time the brokerage fees were collected by ISI are entitled, nevertheless, to participate in any restoration thereof. Counsel for the named plaintiffs contend that the claim for brokerage fees is derivative on behalf of the Fund and that there is no legal requirement that the settlement should benefit past investors.

If the SEC is correct, the proposed settlement, waiving as it does substantially all of the claim for past allegedly improper charges, certainly provides no significant recovery which could be specifically allocated to investors who were such during the period of the charges but who meanwhile disposed of their interests.

However, we do not think it is necessary to pass upon this question of class participation at this time. Whatever the legal or equitable rights of former investors, it is certainly proper in

connection with an appraisal of the adequacy and fairness of the proposed settlement to consider, not only the Fund, but also its investors who were such during the alleged improper charges and still continue to be such and, of course, all other present investors as well as future investors.

ATTORNEYS' FEES

It will be noted that, although the named plaintiffs in their complaint prayed for a court award of costs including counsel fees, they have now presented a proposed settlement providing that ISI will directly pay a stipulated fee of $250,000 to counsel for named plaintiffs, one half on effective date of the settlement and the remainder within a year thereafter.

In the opinion of the court this is not a good practice because in some cases it could be a factor making for a premature or inadequate settlement of a derivative or class action, especially where, as in this case, the named plaintiff, Lawrence Norman, himself an attorney associated with his present local record counsel, frankly admits that he expects to share in the $250,000 fee. Any proposed settlement should be presented in terms of the gross consideration to the Fund or class and the matter of attorneys' fees left for judicial determination and award.

Upon a consideration of the whole record, this court agrees with the conclusions reached by SEC to the effect that for the reasons set forth above, the proposed settlement is so inadequate, and, therefore, so unfair that it should not receive judicial approval.

It is therefore ordered that the proposed settlement, as now presented, be disapproved.

Dated: July 29th, 1968.

/s/ W. T. SWEIGERT
United States District Judge

Appendix C

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CRestview 3-8740
Attorney for Plaintiffs

United States District Court
For the Southern District of California
Northern Division

No. 45079

Lawrence Norman and Elisabeth Norman,
Plaintiffs,

vs.

R. L. McKee, E. R. Foley, W. H. Draper, Jr., Elwood Murphey, J. A. Younger, A. J. Woolsey, W. W. Weeth, Insurance Securities Incorporated, Insurance Securities Trust Fund and Pacific National Bank of San Francisco, Trustee,
Defendants.

COMPLAINT
(CIVIL)

Plaintiff demands trial by jury

Plaintiff, by his attorney, Harold S. Kant, for his complaint, alleges:

1. The jurisdiction of the court is based on the Investment Company Act of 1940, 15 USC §§ 80a-1, et seq. (herein called the "Act") and on the principles of pendent jurisdiction. This action is not a collusive one to confer jurisdiction on this court.

2. (a) Plaintiffs are investors in defendant, Insurance Securities Trust Fund (herein called the "Fund") and have been investors in the Fund since 1963 and at the times of the wrongs complained of herein.

(b) Plaintiffs bring this action derivatively on behalf of the Fund and representatively on behalf of themselves and all other investors in the Fund.

3. (a) The Fund is organized under the laws of California and has its principal office in San Francisco, California.

(b) The Fund is and has been at all times relevant hereto a diversified open-end investment management company and is registered as such under the Investment Company Act of 1940 (the "Act"), 15 USC §§ 80a-1, et seq.

4. Defendants, R. L. McKee, E. R. Foley, W. H. Draper, Jr., Elwood Murphey, J. A. Younger, A. J. Woolsey and W. W. Weeth are the Fund's directors. Defendant R. L. McKee is Chairman of the Board.

5. Defendant, Insurance Securities Incorporated ("ISI") is a California corporation having its principal office in San Francisco, California. It is a registered broker-dealer and acts as the Fund's principal underwriter, manager and as the Fund's regular broker. ISI is not a member of any national securities exchange.

6. Defendant R. L. McKee is and has been the President of ISI. Defendant E. R. Foley is and has been the Senior Vice-President of ISI. Defendant Elwood Murphey is and has been Vice-President and Secretary of ISI.

7. ISI is able to and does dominate and control the Fund and its personnel, its policies and its Board of Directors.

8. § 10(b)(1) of the Act requires that a majority of the Fund's Board of Directors be persons who are not members of, employees of or affiliated with (as such term is defined by §§ 2(a)(3) and 2(a)(9) of the Act) the Fund's regular broker, ISI.

9. § 10(b)(2) of the Act requires that a majority of the Fund's Board of Directors be persons who are not members of, employees of or affiliated with (as such term is defined by §§ 2(a)(3) and 2(a)(9) of the Act) its principal underwriter, ISI.

10. At all times relevant herein, at least 50% of the Fund's directors were and are affiliated with ISI by reason of their being officers of ISI or by reason of their being directly or indirectly controlled by or under common control with ISI in violation of §§ 10(b)(1), 10(b)(2), 2(a)(3) and 2(a)(9) of the Act.

11. In the fiscal years ended June 30 of the following years, ISI received from the Fund brokerage commissions on Fund portfolio transactions in the amounts set out opposite the respective years:

Year	Amount
1962	$ 634,884.00
1963	896,166.00
1964	1,150,662.00
1965	1,092,856.00

12. ISI is continuing to receive substantially similar amounts as brokerage commissions from the Fund.

13. The Fund's portfolio consists and has consisted almost entirely of securities of insurance companies traded in the over-the-counter market.

14. The Fund makes virtually all of its purchases and sales through ISI.

15. The brokerage commissions received by ISI are gratuitous payments to ISI for which no service of value is rendered. They consist of commissions for transactions executed in the over-the-counter market with "market makers" (i.e., dealers who advertise their willingness to buy and sell particular securities) and others all of whom would have dealt directly with the Fund on the same basis as they dealt with ISI. By dealing directly with such persons, the Fund could have saved the commissions paid to ISI.

16. The reason the Fund makes virtually all of its purchases and sales through ISI is that ISI dominates and controls the Fund.

17. The payment of brokerage commissions by the Fund to ISI therefore constitutes a violation of §§ 1(b)(2), 10, 17(h) and (i), 36 and 37 of the Act.

18. These wrongs constitute a waste and spoilation of the Fund's assets and moneys for the benefit of the individual defendants and ISI in violation of the fiduciary duties imposed upon said defendants.

19. The payment of these brokerage commissions to ISI has constituted and continues to constitute an unlawful and willful conversion by ISI and the individual defendants of the moneys, funds, property and assets of the Fund to the use of ISI in violation of the Act and constitutes gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence and a reckless disregard of their fiduciary duties by the Fund's officers, directors and brokers in violation of the duties which the Act imposes upon them.

20. In addition to brokerage commissions, ISI also receives substantial sums from the Fund as advisory fees and receives substantial sums as underwriting and distributing commissions ("creation fees") from the Fund's investors. In the year ended June 30, 1965, ISI received advisory fees of $5,369,282 and net creation fees of $11,539,666. ISI is continuing to receive substantially similar sums as advisory fees and creation fees from the Fund and the Fund's shareholders.

21. § 10(a) of the Act provides that no registered investment company shall have a Board of Directors more than 60 per centum of the members of which are persons who are investment advisors of, or affiliated persons of an investment advisor of, or officers or employees of, such registered company.

22. At all times relevant herein, more than 60 per centum of the members of the Board of Directors of the Fund are and were persons who are investment advisors of, affiliated persons (as such term is defined by §§ 2(a)(3) and 2(a)(9) of the Act) of an investment advisor of, or officers or employees of the Fund.

23. The payment of said advisory fees and net creation fees by the Fund and its investors to ISI therefore constitutes a violation of §§ 1(b)(2), 10, 17(h) and (i), 36 and 37 of the Act.

24. These advisory fees and net creation fees, both individually and collectively, are excessive and constitute waste and spoilation of the Fund's assets and the assets of investors in the Fund in violation of the Act.

25. Demand on the Fund's Board of Directors to bring this action would be futile because,

(a) The defendant directors are the principal wrongdoers, some of whom have personally benefited from the illegal and improper acts alleged herein;

(b) All the Fund's directors have participated, and are continuing to participate, in the alleged wrongs; and

(c) The institution of this action by the directors would place it in hostile hands and would prevent its effective prosecution.

26. The Fund has approximately 175,000 investors whose identity is subject to frequent changes. They are so numerous as to make it impracticable to bring them all before the court. Plaintiffs will fairly insure their adequate representation.

Wherefore, plaintiffs pray for judgment:

(a) requiring the defendants jointly and severally to account for and pay to the Fund the brokerage commissions paid by the Fund to ISI:

(b) requiring the defendants jointly and severally to account for and pay to the Fund the excessive advisory fees and net creation fees paid by the Fund to ISI:

(c) awarding the plaintiffs the costs and expenses of this action, including reasonable counsel fees; and

(d) granting plaintiffs such other and further relief as may be just.

/s/ HAROLD S. KANT
Harold S. Kant, Esq.

Appendix B

[Court and Cause Omitted]

STIPULATION OF SETTLEMENT AND COMPROMISE

Plaintiffs, investors in Insurance Securities Trust Fund (the "Fund"), have brought this action claiming to do so derivatively on behalf of the Fund and representatively on behalf of themselves and all other investors in the Fund.

The Fund is an arrangement set up and established by a certain trust agreement entered into under the laws of California dated December 18, 1939, and from time to time amended in accordance with its terms, among Insurance Securities Incorporated ("ISI"), Pacific National Bank of San Francisco, as Trustee, and the investors from time to time in the Fund (the "Trust Agreement"). Within the meaning of the Investment Company Act of 1940, the Fund is an open-end diversified management investment company and is registered as such under the Act.

Named as defendants in this action are Pacific National Bank of San Francisco, Insurance Securities Incorporated, R. L. McKee, E. R. Foley, W. H. Draper, Jr., Elwood Murphey, J. A. Younger, A. J. Woolsey and W. W. Weeth. Pacific National Bank of San Francisco is the Trustee named in the Trust Agreement and has been joined in its capacity as trustee as a defendant solely because of its alleged failure to bring this action. Each of the investors in the Fund, including plaintiffs, is a beneficiary of the Trust. ISI is the sponsor, investment adviser, principal underwriter, and broker to the Fund. A. J. Woolsey was deceased before this action was commenced and was not served with process. J. A. Younger died after the action commenced and after he had appeared therein as a defendant; his death was suggested on the record herein on August 30, 1967, pursuant to F.R.Civ.Proc. Rule 25(a)(1), and no motion for substitution has been made. During their lifetimes A. J. Woolsey and J. A. Younger were, and defendants McKee,

Foley, Draper, Murphey and Weeth are, directors of the Fund. In November 1967 the name of ISI was changed from Insurance Securities Incorporated to Insurance & Securities Incorporated.

The parties have reached this agreement compromising and settling this action because:

1. Plaintiffs as investors in the Fund desire to settle all claims alleged in the complaint on behalf of the Fund, of all other investors in the Fund and of themselves, in the manner and upon the terms and conditions set forth in this stipulation of compromise and deem such settlement desirable and in the interest of the Fund and its investors.

2. By their answers defendants have denied and continue to deny all material allegations of the complaint and the commission of any wrongdoing, and they disclaim any liability to the Fund or its investors. This suit was commenced on May 9, 1966. The complaint claimed that the payment by the Fund to ISI of brokerage commissions was and is improper and that fees paid to ISI for its services as investment adviser and net creation fees received by ISI were and are excessive. The possibility of settlement of the several claims was first raised during discovery proceedings in this action in October 1966. By negotiation between plaintiffs' counsel and counsel for defendants ISI and others, counsel for plaintiffs proposed in February 1967 that the brokerage claim asserted in the complaint be settled upon the basis of ISI performing the brokerage service at cost in the future. Thereafter, on March 6, 1967, the Securities and Exchange Commission ("SEC"), after a private informal investigation antedating the commencement of the action, instituted private administrative proceedings to determine the lawfulness of ISI's collection of brokerage commissions from the Fund. By virtue of the prosecution of the instant action, the said negotiations and suggestion of February 1967 by plaintiffs' counsel, and the pendency of the proceedings before the SEC, defendant ISI considered it desirable and in the interest of all concerned, including investors in the Fund, to settle the

brokerage claim in this action and the said SEC proceedings upon the basis of ISI performing the brokerage service at cost in the future, retroactive to July 1, 1967, and to settle the remaining claims in this action, as hereinafter provided, all in order to avoid further expenses and the distraction of burdensome and protracted controversy. The SEC proceeding has been settled upon the basis described, which is the same as the basis set forth below for settlement of the brokerage phase of this action, and terminated by an order a copy of which is attached hereto as Exhibit A.

Unless the context clearly indicates otherwise, all terms used herein have the same meanings as in the Trust Agreement.

It Is Therefore Stipulated and Agreed that, subject to the approval of the Court, this action and all claims asserted therein shall be settled and compromised in consideration of defendants' performance of the following acts and things:

1. All amounts collected by ISI from the Fund as brokerage commissions from July 1, 1967 to the effective date of this settlement in excess of "cost of the brokerage service" (as hereinafter defined) shall be or shall have been paid over to the Fund not later than the effective date of this settlement. Such excess totals about $618,286.72 to date. Not later than the effective date of this settlement, ISI, directly or through a subsidiary, will perform "brokerage service" (as hereinafter defined) for the Fund without charge beyond reimbursement of "cost of the brokerage service". By "brokerage service" is meant all of the following services with respect to the purchase and sale of portfolio securities for the account of the Fund, except purchases and sales on a securities exchange:

(a) execution of purchase and sale transactions for the account of the Fund;

(b) operation of a cashier's department for the clearance of all transactions;

(c) arranging for the furnishing of funds which may be required to take delivery of such securities purchased for the Fund; and

(d) all other functions and services required in connection with effecting transactions in such securities for the account of the Fund.

By "cost of the brokerage service" is meant the expense to ISI of performing the brokerage service. If ISI shall perform the "brokerage service", such expenses shall be determined in the following manner:

A. Identifiable direct expenses of ISI will be assigned to each of the four functions performed by ISI for the Fund, namely, brokerage, administrative, sales and investment supervision.

(1) A percentage equal to the percentage which the total dollar volume of purchases and sales of Fund portfolio securities on securities exchanges is of the total dollar volume of all Fund portfolio purchases and sales (but in no event less than 3%) of the direct expenses of ISI's brokerage function will be reallocated as a direct expense of the investment supervision function and not deemed part of the reimbursable direct brokerage expenses.

(2) In order to eliminate from the cost of the brokerage service the cost of executing transactions for investors and prospective investors in the Fund, seven per cent (7%) of the direct expenses of the brokerage function will be reallocated as a direct cost of the sales function and not deemed part of the reimbursable direct brokerage expenses.

(3) Fees charged by the registrar and stock transfer agents relative to ISI's own stock, as distinguished from the securities owned by the Fund, will not be treated either as part of direct brokerage expense, or as part of the indirect expense of ISI for purposes of determining reimbursable indirect expenses.

B. All expenses of ISI other than (a) direct expenses of the brokerage, administrative, sales and investment supervision func-

tions, and (b) Investment Company Institute dues, will be considered indirect expenses. In addition to reimbursable direct expenses, the reimbursable costs of performing the brokerage service for the Fund will consist of such portion of ISI's indirect expenses as bears the same ratio to the total indirect expenses of ISI as the direct brokerage expenses, determined above, bear to ISI's total direct expenses of the four specified functions, with two exceptions, viz.: that interest paid by ISI will not be included as part of any expenses for the purpose of determining reimbursable indirect expenses even where interest paid by ISI is includable as a reimbursable direct expense; and that the amount of the state franchise tax allocated to the reimbursable costs of performing the brokerage service for the Fund will not exceed $35,000 in any one year, which limitation will be increased or decreased to reflect fairly any increase or decrease in such tax resulting from legislative action increasing or decreasing the rate or method of determining such tax.

The foregoing method of determining the "cost of the brokerage service" may be changed only if, upon application by ISI, the United States District Court for the Northern District of California in the above-entitled cause shall have determined that another method is in accordance with sound accounting principles and may properly be used and has so ordered.

If the "brokerage service" is performed by a subsidiary of ISI, "cost of performing the brokerage service" shall be the amount paid to the subsidiary by ISI for the service but not to exceed reimbursement to the subsidiary of its cost of performing the service to be determined in accordance with sound accounting principles. In such event, no allocation of any general administrative expense of ISI will be made to the brokerage service performed by the subsidiary.

During the period of ten years following the effective date of this settlement ISI (or any subsidiary thereof) will not request, accept or retain any brokerage commissions from the Fund in excess of the cost of the brokerage service as defined above.

2. The Trust Agreement presently provides that creation fees shall be 8.85% on single payment Participating Agreements and, in the case of Accumulative Plan Participating Agreements, 7.5% of the first 10% paid by the investor and 9% of the balance paid by him, amounting to 8.85% of the total if all payments are made on the Accumulative Plan Participating Agreement. Not later than the effective date of the settlement ISI will waive any creation fee in excess of 8.5% and no later than the time of submitting the amendment to the Trust Agreement referred to in ¶ 4 below ISI will propose to the Board of Directors of the Fund, for it to propose to the investors in the Fund, and defendant directors of the Fund will use their best efforts to cause to be proposed to the investors, an amendment to the Trust Agreement, and ISI will agree to that amendment if approved by the investors, providing that creation fees will be reduced, as of the effective date of the settlement, to not more than 8.5%. The waiver by ISI shall remain in full force and effect during the period of ten years following the effective date of this settlement regardless of whether the Trust Agreement is amended. By waiver or reduction to not more than 8.5% is meant that the total creation fee will not exceed 8.5% of all payments on a Participating Agreement if and when all such payments have been made. This waiver and reduction shall be applicable not only to investments made after the effective date of this settlement by new investors in the Fund but also (a) to all payments made after the effective date of the settlement by present investors in the Fund on Participating Agreements first entered into by such investors after the effective date of this settlement, and (b) to payments thereafter made of outstanding balances on Accumulative Plan Participating Agreements entered into theretofore so that 8.85% shall be paid by the investor on payments made before the effective date of the settlement and not more than 8.5% on payments thereafter made. The waiver and reduction shall not apply to payments made before the effective date of the settlement.

During the period of ten years following the effective date of this settlement, no increase in these creation fees will be requested, accepted or retained by ISI.

3. Pursuant to the Trust Agreement all Participating Agreements of investment in the Fund mature ten years after the date of their issuance, and at the end of that period the investor receives an amount equal to the then net asset value of his shares. Under the Trust Agreement in effect at the commencement of this action, an investor choosing to reinvest in a new Participating Agreement upon the maturity at the end of ten years of a prior Participating Agreement was required to pay a new creation fee at full rates. After the filing of the complaint in this action, ISI waived any creation fee on reinvestment of all or any portion of the proceeds payable upon maturity of any Participating Agreement first entered into on or after March 27, 1967, and waived creation fees in excess of 5% on such reinvestment in the case of all Participating Agreements outstanding on March 24, 1967. Defendant ISI agrees that during the period of ten years following the effective date of this settlement, no increase in these creation fees on reinvestments will be requested, accepted or retained by ISI. By "reinvestment" is meant use of the proceeds within 60 days of maturity of a Participating Agreement to purchase a new Participating Agreement.

4. Not later than January 1, 1969 (if the effective date of the settlement has occurred by then, and if not, then not later than ninety (90) days after such effective date) ISI will propose to the Board of Directors of the Fund, for it to propose to the investors in the Fund, and defendant directors of the Fund will use their best efforts to cause to be proposed to the investors, an amendment to the Trust Agreement, and ISI will agree to the amendment if approved by the investors, providing for a new schedule of fees covering the services by ISI of administration, investment supervision and management and of the trustee's fees, that is, all services other than brokerage and sales. The new schedule need not

be applicable to any Participating Agreement written before the effective date of the amendment but shall be applicable to all investments in the Fund, in whatever form, written on or after the effective date of the amendment, including those made by present investors as well as by new investors. The new schedule or the amendment may provide for less frequent distribution of dividends and capital gains than the present monthly distribution of each, and the charges imposed under that schedule shall be such that, had the schedule been in effect and applicable to all investments outstanding in the Fund during 1967, the total fees received by ISI for such services on all such investments outstanding in 1967 would have been at least $700,000 less than those actually received in 1967. The new schedule may or may not provide that such charges shall be paid by the Fund in the first instance instead of directly by the investors as heretofore. Said schedule shall not be altered or amended to increase the rate of said fees during the ten years following the effective date of the amendment unless (1) such increased fees are justified by a substantial change of circumstances, (2) the United States District Court for the Northern District of California shall have entered an order permitting the Fund to solicit the investors for approval of the payment by the Fund to ISI of such increased fees, and (3) the payment of such increased fees by the Fund to ISI shall have been approved by the holders of a majority in interest of the outstanding investments in the Fund. Promptly after the adoption of the amendment ISI will take all steps necessary for registration under applicable federal laws of the security embodying the amendment and to obtain a California permit therefor. The effective date of the amendment shall be the date when necessary registration has been effected and a permit obtained.

5. No counsel fees whatever shall be paid by the Fund. Counsel fees of $250,000 shall be paid by ISI to plaintiffs' counsel. Defendants have conditioned this settlement upon the agreement of plaintiffs' counsel to accept this payment in full settlement

of all claims for counsel fees and other expenses in connection with the prosecution and settlement of this action. Such counsel fees and expense reimbursement shall be payable one-half upon the effective date of this settlement and one-half within one year thereafter.

6. (a) As soon as practicable hereafter, the parties shall make application to the Court for approval of this stipulation of settlement and compromise and in furtherance thereof plaintiffs will apply for an order under F.R.C.P. Rule 23(c) determining that the action may be maintained as a class action.

(b) The cost of any notice to the investors as directed by the Court pursuant to the Federal Rules of Civil Procedure shall be borne by ISI.

(c) If this stipulation of settlement and compromise shall be approved by the Court, judgment shall be entered in the appropriate form to the following effect:

(i) approving this stipulation of settlement and compromise,

(ii) dismissing this action with prejudice and without cost to any party as to all defendants other than ISI,

(iii) ordering and enjoining defendant ISI, but without cost to any party, to perform and carry out each of the matters which it has herein above agreed to do,

(iv) adjudging and decreeing that, other than the relief provided for in subparagraph (iii) above, neither any of the plaintiffs, the Fund, the Trustee nor any investors shall have or recover anything against defendant ISI, its successors, assigns, officers, directors, agents and employees by virtue of any and all claims and causes of action asserted in the complaint or which could or might have been alleged or asserted at any time prior to the consummation of this settlement on the basis of the acts, omissions, facts, matters or transactions alleged or referred to in the complaint herein, or in connection with any fees or commissions of any kind received by ISI from investors or from the Fund, and

(v) reserving jurisdiction of the cause for the purposes of construction or enforcement of the judgment herein.

(d) If this stipulation of settlement and compromise shall not be approved, then this stipulation of settlement and compromise shall become ineffective, and all proceedings had in connection therewith shall be without prejudice to the rights of any party hereto including the determination that the action may be maintained as a class action.

7. The effective date of the settlement shall be the fifth day after the end of the time to appeal from final judgment of this Court in this action entered in conformity with paragraph 6(c) above, without any appeal therefrom having been taken, or the fifth day after all appeals (including petitions for certiorari and rehearing) and any proceedings resulting therefrom shall have been finally determined approving this stipulation of settlement and compromise and the judgment entered in conformity therewith.

Dated: February 21, 1968.

MOSES LASKY
BROBECK, PHLEGER & HARRISON

By /s/ MOSES LASKY

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By /s/ HAROLD S. KANT

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By /s/ ABRAHAM L. POMERANTZ

Of Counsel to Plaintiffs.

EXHIBIT A

(Securities Exchange Act Release No. 8226)
(Investment Company Act Release No. 5233)
(Investment Advisors Act Release No. 215)

Administrative Proceeding
File No. 3-981-5

United States of America
Before the
Securities and Exchange Commission
January 11, 1968

In the Matter of
Insurance Securities Incorporated
(8-7308)

ORDER ACCEPTING OFFER OF SETTLEMENT

This proceeding was instituted by Order for Proceedings on March 6, 1967, pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"). The Order alleged violations of Sections 10(b) of the Securities Exchange Act and Rule 10(b)(5) thereunder, Section 15(c)(1) of the Securities Exchange Act and Rule 15(c)(1) thereunder, Section 17(e)(1) of the Investment Company Act of 1940, and Section 206(2) of the Investment Advisers Act of 1940.

In the interest of settling this matter, ISI has submitted an Offer of Settlement under which ISI proposes to cease charging Trust a brokerage commission in connection with its trading activities and, commencing as of July 1, 1967, to receive its cost for performing such activity, and to propose to the shareholders of the Trust an amendment to the Trust Agreement to so provide. Further, during the three calendar years 1968, 1969, and 1970,

ISI will waive any reimbursement from the Trust Fund for the cost of performing trading activities which is in excess of $350,000 per year. The cost to ISI of performing the trading activities for the year ending June 30, 1967, was $259,353, while for the same period it received fees designated as brokerage commissions from Trust Fund of $1,348,354. Reimbursement of ISI's costs by Trust Fund, therefore, would have resulted in a saving to Trust Fund of 78% for the year ending June 30, 1967.

ISI has waived a hearing, post-hearing procedures and the separation of functions between the staff and Commission in the preparation of any opinion of the Commission and, solely for the purpose of this Offer of Settlement, has agreed with the staff to the following Stipulation of Facts:

1. Insurance Securities Trust Fund ("Trust Fund") is a registered open-end diversified management investment company within the meaning of the Investment Company Act of 1940. The Trust Fund was created in 1938 and operates under a Trust Agreement between Insurance Securities Incorporated ("ISI"), a California Corporation, Pacific National Bank of San Francisco as Trustee, and the holders from time to time of Participating Agreements issued by the Trust Fund.

2. The Trust Fund registered as an investment company under the Investment Company Act of 1940 on November 1, 1940.

3. Trust Fund issues securities designated as Participating Agreements. Net funds received from investors purchasing Participating Agreements were invested from Trust Fund's inception in 1938 to 1965 in a group of common stocks restricted to an eligible list of insurance companies and holding companies with assets primarily consisting of insurance company shares. During 1965, Trust Fund's eligible list of stocks was expanded to include bank stocks. At the present time, the eligible list includes 193 companies. The eligible list of stocks is incorporated as a provision of the Trust Agreement upon approval by the holders of Participating Agreements and is set out in the Trust Fund's

prospectus which is available to the public, including dealers who trade in securities on such list. As of December 31, 1966, Trust Fund had net assets of $1,083,099,639.

4. The Trust Agreement provides, among other things, that ISI will act as manager, underwriter and investment adviser of the Trust Fund.

5. As manager of Trust Fund, ISI performs the general managerial duties involved in the day-to-day operation of Trust Fund's affairs. Since Trust Fund has no officers or employees, the officers and employees of ISI carry out the managerial responsibilities on behalf of Trust Fund. Prior to 1956, management of Trust Fund was solely in the discretion of ISI. In 1956, the Trust Agreement was amended to provide for a seven-man board of directors of Trust Fund. ISI retained responsibility for management of Trust Fund, but became subject to the supervision of Trust Fund's board of directors.

6. In its capacity as manager and investment adviser of the Trust Fund, ISI determines what securities are to be purchased for and sold from the Trust Fund's investment portfolio, determines how much of a given security is to be purchased or sold, and orders the purchase or sale of such securities. In connection with ISI's duties as investment adviser, ISI furnishes the statistical and research facilities and services incident to the management of the portfolio, some of which facilities and services are used in determining which securities to purchase or sell, in what quantities and at what prices.

7. As principal underwriter for the Trust Fund, ISI sells and distributes through its salesmen the Participating Agreements issued by the Trust Fund. Purchasers of the Participating Agreements authorize the charge and deduction of an 8.85% Creation Fee, or sales commission, from the amounts agreed to be paid by them, which is payable for its activities as underwriter. The Creation Fee has no front-end load feature.

8. The Trust Agreement delegates to ISI most of the administrative duties required by such Agreement. In accordance with this delegation, ISI keeps the record and accounts of the Trust Fund and of the holders of the Participating Agreements, accounts for the income collected for the Trust Fund, provides office space and equipment, and performs a wide variety of administrative duties and services incidental to the day-to-day operations of the Trust Fund and for the benefit of the holders of Participating Agreements.

9. Holders of Participating Agreements authorize the charge and deduction over a ten-year period of a combined management, administrative, and trustee's fee ("MAT fee") which may not exceed five percent of the amount agreed to be paid by them. Under the Trust Agreement this MAT fee is divided between an "Administrative Fee" and an "Investment Supervision and Management Fee." The Trust Agreement provides that the "Administrative Fee" shall be divided between the Trustee and ISI in such manner as they may mutually agree, and that the "Investment Supervision and Management Fee" shall be paid to ISI "for its services rendered in selecting, ordering the purchase of securities, advising Trustee in detail of such purchase, issuing draft in payment thereof, and supervising the investment portfolio, including the investment of all new funds."

10. During the early period of the Trust Fund's operations following its inception in 1938, ISI followed the practice of ordering the purchase and sale of Trust Fund securities with a single broker-dealer located in Oakland. From 1940 to 1946, substantially all transactions were still conducted with a firm located in Los Angeles. Throughout the period until 1956, the list of broker-dealers with which transactions were conducted was gradually expanded so that by 1956 Trust Fund portfolio transactions were conducted with thirty-four broker-dealer firms, although the great bulk of the business was still conducted with

eight firms. During this period ISI was either merely giving orders or passively receiving offers from these chosen brokers, and most transactions were confirmed on a net price, which included the firm's markup. Ultimately, however, there was a significant expansion of the number of broker-dealer firms with which the Trust Fund had transactions. In 1965 Trust Fund transactions were conducted with one hundred forty broker-dealer firms, although most of the transactions were conducted with twenty broker-dealer firms. Many of the foregoing broker-dealer firms specialized in insurance securities and all of them made most of their offerings to ISI of such securities as principals.

11. At all times prior to 1957 the management of ISI undertook, with the facilities and resources at its disposal, to secure the most favorable securities and price with respect to the Trust Fund's portfolio transactions. In 1957, following the acquisition of control of ISI by a new group in 1956, ISI began experimenting with a number of new techniques, particularly with respect to the purchase of securities for the Trust Fund. The company took measures designed to obscure the current interest of the Trust Fund in specific insurance securities, encouraged broker-dealers to make offerings of all securities on the Trust Fund's eligible list as described in Paragraph 3 above, and substantially expanded the number of broker-dealer firms with which business was conducted. The company adopted the policy of soliciting a great number of broker-dealers to submit offerings to ISI, and substantially all transactions thereafter were negotiated with firms making such offerings. The company also established a cashiering department to clear purchases and sales on behalf of the Trust Fund. ISI contends that these techniques were intended to result in more favorable executions and price for the Trust Fund. In April 1959, ISI registered as a broker-dealer under Section 15(b) of the Exchange Act. Thereupon, ISI began to execute on a commission basis substantially all transactions in the over-the-counter

market in which securities were acquired or sold for the Trust Fund portfolio. The commission charged was equal to the New York Stock Exchange commission on all such transactions. ISI does not execute transactions on a commission basis for any other customers.

12. The Trust Fund's portfolio has through the years been concentrated in insurance securities, and more recently bank stocks have been added to the eligible list. The insurance securities market is a specialized type of market and almost all insurance securities are unlisted and traded in the over-the-counter market. The same is substantially true for bank securities. The over-the-counter market is a negotiated market and there is no fixed schedule of commission rates. Of the 193 securities that are eligible for investment by the Trust Fund at the present time, practically all are unlisted securities which are sold in the over-the-counter market. Through the years the buying power of the Trust Fund has expanded substantially due to the increase in sales of participating agreements in the Trust Fund. As a result, the Trust Fund has become recognized as a volume purchaser in the insurance securities market and, indeed, today is one of the most substantial purchasers of insurance securities in the country. This fact is widely known through the investment community, and ISI continuously receives offers from many broker-dealers of securities which are on the eligible list.

13. Until recently ISI's Executive Committee had the responsibility of determining what securities should be bought or sold on behalf of the Trust Fund. ISI's Research Department rated all companies on the Trust Fund's eligible list at least annually in terms of underlying quality on a 1-to-10 scale, 1 being the highest rating. In addition, periodically on a monthly basis, and more frequently where changes in market or other conditions required it, the securities on the eligible list were rated by the Research Department in cooperation with the investment officers

on a 1-to-4 scale basis—the rating taking into consideration general availability, market activity, and price range of offerings being received by ISI, the then holdings of the security by the Trust Fund, its quality as determined by the research staff, and current developments or other events affecting the rated company. These ratings were submitted to and analyzed by the Executive Committee. Purchases were then made on the basis of this scale with preferences being given to those rated 1 and with no purchases being made on the securities rated 4. Offerings were communicated to the company by telephone or telegraph and a record of such offerings on a stock offering sheet was maintained for review by the company. In addition, as an aid in ascertaining the market price, quotation sheets were supplied daily by First Boston Corporation to the Company. ISI's two investment officers, a Vice President and an Assistant Vice President, who with one assistant constituted the company's marketing department, reviewed the offerings as received and were authorized by the Executive Committee to purchase securities from time to time within the framework of the current rating schedule and any specific direction. The Executive Committee, which retained sole responsibility for purchases and sales in special situations, was also available for special meetings and consultation for special situations or where more specific instructions were necessary. All securities purchased were reviewed and ratified by the Executive Committee each day. All sales were made upon specific authorization of the Executive Committee.

In 1966 a revision of procedure took place and the investment function is currently the responsibility of an Investment Committee which is separate from the Executive and Management Committees of the company. Under present procedure all securities of the Trust Fund are periodically reviewed by the Investment Committee. Specifically, securities are placed upon a "buy list" with price and quantity limitation fixed and certain securities designated

as "aggressive" buys. Similarly, certain securities are placed upon a "sell list," with price limitations fixed, some to be sold on an aggressive basis, others to be on a "market work-out" basis. Other securities are maintained on a continuing review status. All prices and classification determinations are subject to constant review.

The Investment Committee meets daily in the morning and reviews market conditions and all offerings and bids which may be of appropriate size, and instructions are given to the investment officers as to procedure. The Vice President and principal investment officer is a member of the Investment Committee but not its Chairman. Where price limitations have been fixed, the investment officers are authorized to effect purchases and/or sales within quantity limitations. All sales and purchases are reviewed daily by the Investment Committee with procedures and programs reviewed and changed as market and other conditions warrant.

14. The following table demonstrates the growth in the total assets of the Trust Fund and the substantial increase in portfolio transactions during the period 1954 through 1966 inclusive. It also shows the brokerage commissions paid by the Trust Fund to ISI during that period.

Fiscal Year Ended December 30	Total Assets of Trust Fund	Total Gross Dollar Amount of Trust Fund Portfolio Transactions		Brokerage Commission Received by ISI from Trust Fund for Fiscal Year Ended June 30
		Gross Purchases	Gross Sales	
1954....	$ 157,076,845	$ 30,961,506	$ 3,750,942	—
1955....	215,585,625	55,926,202	4,048,566	—
1956....	212,020,880	36,745,495	1,141,712	—
1957....	224,092,891	29,676,199	4,244,067	—
1958....	357,385,592	40,249,695	10,587,112	—
1959....	419,636,187	54,604,691	2,939,289	$ 78,742
1960....	486,136,869	45,048,979	13,051,600	297,455
1961....	842,705,524	74,586,843	7,961,640	513,594
1962....	883,431,749	112,967,379	19,445,596	634,884
1963....	1,159,583,906	145,918,221	17,391,414	896,166
1964....	1,334,049,086	207,014,677	33,354,549	1,150,662
1965....	1,348,067,010	86,558,610	38,876,142	1,092,856
1966....	1,083,720,108	37,334,641	91,220,417	767,849
1967....	—	—	—	1,348,354

15. It is the contention of the Divisions of Corporate Regulation and Trading and Markets that it is unjustifiable for ISI to charge the Trust Fund a fee, in addition to the MAT fee, as a brokerage commission, in that:

(a) Most, if not all of what ISI asserts to be its brokerage activity is actually part of the company's management, investment advisory and administrative responsibilities to Trust Fund. These responsibilities include, at the very least, the determination to purchase a particular security on the Trust Fund's eligible list, in a particular quantity and at a particular price. This is a management function, not a brokerage function;

(b) ISI's trading activities are so interwoven with management, investment advisory and administrative duties performed by ISI that separating ISI's activities in two categories, management, investment advisory and administrative on the one hand, and brokerage on the other hand, is more artifical[sic] than real;

(c) ISI's position of receiving daily offerings from many broker-dealer firms on a net basis makes any actual brokerage activity done by ISI attenuated to the point where it is unnecessary for the Trust Fund to place a broker, as its agent, between itself and the broker-dealer firms offering to sell securities. The Trust Fund, or ISI as Trust Fund's management, could deal directly with offering broker-dealers on a net basis, as ISI had done prior to 1959, without the payment by Trust Fund of any brokerage commission.

(d) ISI accepted compensation for the purchase and sale of portfolio securities, as agent for the Trust Fund, and not in the course of any business of ISI as underwriter or broker;

(e) ISI's charging the Trust Fund a fee as a brokerage commission is in violation of the terms of the Trust Agreement;

(f) ISI failed to disclose to Trust Fund, its shareholders and prospective shareholders, that before ISI began exacting fees as Trust Fund's sole broker it performed, without charge, essentially the same service as it performed thereafter with respect to the acquisition and disposition of portfolio securities, that ISI's services to Trust Fund were not as broker but as manager and investment adviser, for which it was already being compensated pursuant to the terms of the Trust Agreement and that it was not necessary for Trust Fund to employ a broker to acquire or dispose of portfolio securities on behalf of Trust Fund; and

(g) In the circumstances, the activities of ISI constitute violations of Sections 10(b) and 15(c)(1) of the Exchange Act, Section 17(e)(1) of the Investment Company Act of 1940, and Section 206(2) of the Investment Advisers Act of 1940.

16. ISI, on the other hand, contends that its activities are those of a broker, are completely lawful, are not in violation of the Trust Agreement, and are specifically permitted by Section 17(e)(2) of the Investment Company Act of 1940. The company contends also that its activities during the period 1957 to 1959, prior to its registration as a broker-dealer, were for the purpose of experimenting to determine whether the company could beneficially perform a brokerage function for the Trust Fund, that the results of such experiment were favorable, and that its activities thereafter as a broker in fact resulted in better executions and afforded substantial savings to the Trust Fund.

The Commission notes that the staff has charged ISI with serious violations of the federal securities laws, arising out of the practice by which ISI performed alleged brokerage functions at a profit in connection with the purchase and sale of over-the-counter securities on behalf of the Trust Fund. While ISI has denied any violations contained in the Order for Proceedings, it has agreed to

discontinue, retroactively as of July 1, 1967, from charging any amounts in excess of the administrative cost of the services performed in connection with the purchases and sales of such securities for and on behalf of the Trust Fund, and consents to the entry of a cease and desist Order to this effect.

The Offer of Settlement provides that the Commission will not make findings as to whether or not the practices of ISI violated the federal securities laws. The Commission has determined to accept this Offer of Settlement, despite this limitation, in view of the unique circumstances of this particular situation and the benefits which will result to the shareholders of the Trust Fund from a prompt disposition of the matter. Our acceptance of this offer, however, in no sense implies that we are persuaded that the activities engaged in, as set forth in the Stipulation of Facts, did not violate the federal securities laws, or that we in any way condone them, and accordingly

It Is Ordered that the Offer of Settlement be, and it hereby is accepted.

It Is Further Ordered that ISI cease and desist, retroactively as of July 1, 1967, from charging any amounts in excess of the administrative cost of the services performed in connection with the purchases and sales of over-the-counter securities on behalf of the Trust Fund, and that the proceeding be, and hereby is, terminated.

By the Commission (Chairman Cohen and Commissioners Budge, Wheat and Smith), Commissioner Owens dissenting, as follows: "I cannot give my assent to an order of settlement which is predicated upon the proposition that the Commission is precluded from making a finding of legal violations if under the factual stipulation such findings are indicated."

Orval L. DuBois
Secretary

/s/ NELLYE A. THORSEN

By Nellye A. Thorsen
Assistant Secretary

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 992

ISI CORPORATION, R. L. MCKEE, E. R. FOLEY, and ELWOOD MURPHEY,

Petitioners,

vs.

ALMA M. MYERS and MYRTLE G. CROMWELL, as Executrices of the Will and Estate of Ethel I. Bumbaugh, STEVEN G. OPTON, LAWRENCE and ELISABETH NORMAN, SECURITY PACIFIC NATIONAL BANK, W. H. DRAPER, JR. and W. W. WEETH.

Response of Security Pacific National Bank in Support of Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

Respondent Security Pacific National Bank supports the position of petitioners herein, and asks that the writ be granted for the reasons stated in the Petition.

Dated: December 16, 1970.

Respectfully submitted,

WILLIAM W SCHWARZER

BRENT M. ABEL
JOHN R. REESE
MCCUTCHEN, DOYLE, BROWN & ENERSEN
Of Counsel